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100TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPT. 100-816
Part 7

UNITED STATES-CANADA FREE-TRADE AGREEMENT IMPLEMENTATION ACT OF 1988

AUGUST 5, 1988.—Ordered to be printed

Mr. DINGELL, from the Committee on Energy and Commerce, submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany H.R. 5090 which on July 26, 1988, was referred jointly to the Committee on Ways and Means, the Committee on Agriculture, the Committee on Banking, Finance and Urban Affairs, the Committee on Energy and Commerce, the Committee on Foreign Affairs, the Committee on Government Operations, the Committee on Interior and Insular Affairs, and the Committee on the Judiciary]

[Including cost estimate of the Congressional Budget Office]

The Committee on Energy and Commerce, to whom was referred the bill (H.R. 5090) to implement the United States-Canada Free-Trade Agreement, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

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Purpose and Summary

Both the United States and Canada have a large bilateral trading relationship with each other than with any other country in the world. In 1987, the United States exported goods valued at $59.8 billion to Canada, and Canada exported goods valued at almost $72.7 billion to the United States, providing total bilateral merchandise trade of $132.5 billion.

In addition, United States-Canada bilateral trade in services reached $11 billion in 1986. United States-Canada bilateral direct investment is now valued at $67 billion.

Trade with the United States is very important to Canada. Canadian trade with the United States has more than doubled since 1980. During the same period, Canada's trade with the European Community has declined, and trade with the Japanese has risen only 35 percent.

Greater access to the U.S. market which the United States-Canada Free-Trade Agreement will give Canada is expected to give Canadian producers the ability to achieve greater specialization of production. Canada has a population of only about 25 million people—one-tenth the size of the United States. Not having access to a large domestic market has made it difficult for Canadian firms to achieve high levels of efficiency in production.

The Agreement is expected to increase Canada's GNP between 2 and 5 percent. U.S. GNP is expected to rise by one percent. In Canada, 1 in 5 jobs already depend on trade with the United States, in the United States only 1 in 100 depend on trade with Canada. United States-Canadian trade is estimated to rise by $25 billion over the next 5 years, as a result of the Agreement.

The Agreement is expected to aid U.S. exporters of furniture, telecommunications equipment, home appliances, electronics and paper products with the removal of high tariffs on these products. More than 14,000 new American jobs are projected to be created due to the elimination of tariffs alone. In particular, small- and medium-sized companies and high technology companies that are shut out by Canada's high tariffs are expected to benefit.

The reduction of barriers on direct investment and on U.S. service industries should especially benefit banks and other financial service firms. In addition, regions of the United States that import

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energy resources from Canada should be helped by having access to cheaper supplies of Canadian energy.

Background and Need for the Legislation

HIGHLIGHTS OF THE AGREEMENT

The Agreement provides for the elimination of almost all tariffs between the United States and Canada within 10 years. Of those items subject to duties, Canadian tariffs average 9 to 10 percent, whereas U.S. tariffs average 4 to 5 percent.

In general, the United States negotiating objectives concerning tariffs and services were obtained. Limited progress was made on relaxing Canadian non-tariff barriers and investment restrictions, and very little progress was made on intellectual property rights and subsidies. The Agreement provides for a United States-Canada working group to develop new rules governing the treatment of subsidies within 7 years. Either country's failure to adopt the new subsidies code would be grounds for the other country to withdraw from the Agreement.

The Committee notes that Canada's Parliament is not likely to act on the Canadian counterpart to this legislation until after elections are held in the fall. To ensure that we are not the only ones properly implementing this Agreement, this legislation requires the Trade Representative to report to Congress not later than December 15th concerning changes in Canada's laws, regulations, policies and practices necessary to fully implement its obligations under the Agreement. In this way, the Congress will have the information it needs to be able to evaluate whether Canada has fully complied with its obligations under the Agreement.

CHAPTER FOUR: BORDER MEASURES

Trade in automotive vehicles and parts accounts for one-third of all trade between the United States and Canada. Since 1981, the United States-Canada balance of trade in automotive products has gone from a surplus for the United States of $1.1 billion to a deficit of $6.8 billion. During this time, the value of imports from Canada of both finished cars and automotive parts has more than doubled.

This decline in U.S. auto trade with Canada has caused the U.S. auto parts industry to seek major policy changes through the Agreement. Although the Agreement does contain some provisions that may help the U.S. parts industry, the industry considers the Agreement generally to be inadequate.

Currently, United States-Canada auto trade is governed by the 1965 Auto Trade Pact. Under the pact, auto products cross the United States-Canada border duty free, under conditions that have raised the concern of many in the U.S. industry.

Since Canada feared that the elimination of tariffs under the Auto Pact might lead to the Big Three U.S. auto makers shutting down auto production in Canada, Canada imposed certain conditions or "safeguards" on U.S. auto makers that sought to enter automotive products into Canada, on a duty-free basis. To be eligible to import duty-free into Canada, the Canadian auto firms (the U.S. Big Three and soon the GM-Suzuki joint venture) had to

agree: (1) to produce approximately as many cars in Canada as they sell in Canada; and (2) to achieve a 60 percent Canadian content for cars sold in Canada. These requirements were designed to promote the Canadian parts industry.

On the other hand, the United States allows any auto maker to be eligible for duty-free treatment under the Auto Pact that imports cars or parts containing 50 percent North American content (rather than the 60 percent Canadian content that Canada requires).

The Free Trade Agreement would not change Canada's requirement that automakers achieve 60 percent Canadian content to be eligible for duty free entry into Canada under the Auto Pact. The Agreement does, however, eliminate overhead expenses and profits from the 50 percent North American content requirement that the United States uses to establish eligibility for duty-free entry into the United States.

For non-Auto Pact companies, Canada has developed two duty remission programs that provide benefits like the Auto Pact. Under Canada's export-based duty remission program, auto firms in Canada are allowed to reduce the value of motor vehicle and parts imports subject to Canadian duties by up to 70 percent of the value of Canadian made auto parts that the firm exports to the United States or any other country. This program has the effect of drawing more Japanese and Korean vehicle imports into Canada and pushing subsidized exports of Canadian parts to the United States and other countries.

Under Canada's production-based duty remission program, auto companies with a significant manufacturing facility in Canada (Honda, Toyota, Hyundai and the GM-Suzuki joint venture now qualify) can be eligible for duty remission on automotive imports coming into Canada for up to 100 percent of the value of the auto company's production in Canada.

The Free Trade Agreement would eliminate Canada's export-based duty remissions on January 1, 1989 for exports to the U.S. and January 1, 1988 for exports to all other countries. Canada's production-based duty remissions will not end under the Agreement until January 1, 1996.

The Committee notes that the Agreement does not meet the needs of an important share of the auto industry; namely, the auto parts manufacturers and the North American workers. Of particular concern is the failure of the Agreement to reach a 60 percent content level, which is important to workers in both countries and to the auto parts workers. As a result, the Administration has made a commitment to take certain steps to maximize the benefits of the Agreement to these entities and workers. For example, the Administration has stated in the statement of administrative action that it intends to increase the level of customs personnel at the border to ensure that the new, tougher North American content requirements in the Agreement are fully enforced.

The legislation contains authority for the President to negotiate an agreement with Canada to raise the North American content requirements in the Free Trade Agreement from their present level of 50 percent to 60 percent, which is what the U.S. position in the negotiations was to begin with. In this effort, the Administra-

tion has committed to support the need for a greater percentage. The Administration has also agreed to review Canada's production based duty remission program, which under the Agreement would be allowed to continue until 1996, to determine whether an unfair trade practices investigation should be initiated under title III of the Trade Act of 1974.

Many of these understandings and commitments were the result of joint and cooperative efforts by this Committee and the Committee on Ways and Means as part of discussions preceding the transmittal of the legislation to Congress, as well as extensive Committee correspondence (see Agency Views).

CHAPTER SEVEN: AGRICULTURE

Technical Regulations and Standards for Agricultural Food, Beverage and Certain Related Goods

The Committee has jurisdiction over one of the nation's major food safety statutes—the Federal Food, Drug and Cosmetic Act (Act). Under the Act, the Food and Drug Administration (FDA) regulates all food (except meat and poultry) for adulteration, misbranding and environmental contamination and approves prior to marketing all food and color additives and animal drugs (including those used in animal feeds), and the Environmental Protection Agency (EPA) regulates the amount of pesticide residues which may remain in food at the time of consumption. Given this jurisdiction, the Committee is concerned with the impact of the Agreement on the regulatory responsibilities of the FDA and EPA under the Act.

The Agreement contains certain commitments by the Federal Government regarding the regulation of food products that are subject to trade between the two countries. The Committee sought clarification from the Administration about the obligations of the federal government under the implementing legislation and Statement of Administrative Action to preempt states that regulate in the same areas as the Act. The Committee has been assured by Administration representatives that the Administration does not interpret the Agreement or the implementing legislation to impose any requirement on the Federal Government to preempt state laws and regulations that cover these same areas regulated by FDA and EPA as long as the state regulation is intended to reach legitimate public health and safety objectives and is applied equally to all domestic and foreign food products. The Administration included a specific comment to this effect in the Statement of Administrative Action.

The Agreement also commits the federal agencies that regulate food products to participate in "working groups" that will address, on an ongoing basis, differences in regulatory standards between the two countries. While the Committee understands that these working groups are an integral part of implementing the Agreement, the Committee is concerned that the effect of requiring regulatory agencies responsible for public health to consider the trade implications of their regulatory standards could be to diminish important public health protections.

To address the Committee's concern, the Administration agreed to include language in the Statement of Administrative Action that commits FDA and EPA to certain procedural steps in the event they decide to make a significant change in their regulatory schemes as a result of the activities of the working groups. All proposed regulations would, of course, require notice and comment procedures. The Administration has agreed that other significant changes, such as those made in general statements of policy or interpretive rules, would also go through such notice and comment procedures. With these procedural safeguards, the Committee is satisfied that the process of making changes in food safety regulation will give appropriate consideration to trade concerns.

CHAPTER NINE: ENERGY

Chapter Nine applies to measures related to trade in petroleum, natural gas, coal, electricity, uranium, and other nuclear fuels.

In this Chapter, the United States and Canada reaffirm their rights and obligations on bilateral trade in energy; state their understanding that this prohibits minimum export pricing requirements and import pricing restrictions or quotas; and prohibits discriminatory export taxes.

If exports are restricted in situations where supplies are short, there is a domestic price control program, or a need exists to conserve a finite energy resource as permitted under the GATT, the restriction may not:

—reduce the proportion of total supply historically available to the other country;

—disrupt the normal channels of supply or mix of energy supplies; or

—impose a higher price on exports than for comparable domestic sales.

The Agreement provides only narrow exceptions to the prohibition on trade restrictions in situations involving national security, which are limited to instances of militarily-related national security.

In sum, neither country will treat the buyers or sellers of energy in the other country as "second class" customers or suppliers. Canada gains assured nondiscriminatory market access for its energy exports to the United States, and the U.S. gains assured access to Canadian energy supplies to meet its imported energy requirements.

The Agreement provides for consultation in the event either country believes the energy regulatory acitons of the other country would directly discriminate against its energy goods or businesses. This consultative link is in addition to the consultation provided for in Chapter Eighteen of the Agreement and recognizes the complexity of energy regulatory programs and their potential effects on energy trade. This provision will encourage constructive consultations between the governments with a view to avoiding problems that could otherwise require dispute settlement under the procedures of Chapter Eighteen.

Under the Agreement, Canada will: exempt the United States from its "upgrading" requirement on uranium exports; and elimi-

nate the electricity export price test that require the export price to be not significantly less than the least-cost alternative available to importer. Other Canadian export tests (price tests and "surplus" tests) must be administered in a manner consistent with the Agreement.

The United States will: eliminate any discriminatory treatment of British Columbia Hydro vis-a-vis comparably situated U.S. utilities in terms of access to the Bonneville Power Administration Intertie into the California electricity market; allow export of up to 50,000 barrels per day of Alaskan crude oil (the export of which is currently prohibited by U.S. law) only if carried from Alaska on vessels documented for the U.S. coastwise trade; and exempt Canada from restrictions in Section 161(v) of the Atomic Energy Act on domestic enrichment of imported uranium.

The FTA recognizes the importance of government incentives for oil and gas resource development in view of the contribution of such incentives to the overall energy supply security of both countries. Neither country is required to eliminate such incentives as a consequence of implementing the Agreement, and may create new ones consistent with the principles of the Agreement.

Finally, Chapter Nine expresses the Parties' intent that there be no inconsistency between this Agreement and the obligations of either country under the International Energy Program of the International Energy Agency.

National treatment

The Agreement reaffirms the "national treatment" obligations which exist today under the GATT and which already apply to Canadian and United States governmental actions affecting United States-Canadia energy trade.

The "national treatment" obligation means that laws and regulations should not discriminate between foreign and domestic energy on the basis of nationality. For example, imports of Canadian natural gas and electricity will, under both GATT and now the Agreement as well, be accorded treatment no less favorable than U.S. natural gas and electricity, under all U.S. laws and rules respecting the sale, licensing, shipment, distribution, and use of gas and electricity.

This obligation extends to rules and decisions of the Federal Energy Regulatory Commission (FERC) and the Economic Regulatory Administration (ERA) of the Department of Energy (DOE), for example, and to other U.S. Federal and State governmental agencies. Of course, it applies equally to Canadian Federal and Provincial agencies, such as the National Energy Board (NEB).

Practices forbidden under this obligation would include, for example, a domestic rule in either nation imposing an internal quantitative requirement that a specified portion or percentage of natural gas or electricity needs be supplied from domestic sources, or that no foreign coal or oil be marketed to domestic buyers.

Equal Opportunity

In sum, "national treatment" requires giving Canadian energy imports an equal opportunity to compete and win in U.S. markets. However, neither FERC, nor DOE, nor any other government

agency is required to assure Canada's success in this competition, and U.S. regulations that might indirectly lead to lower Canadian sale volumes or prices in the United States do not necessarily mean that Chapter Nine's "national treatment" obligation is being violated.

But Canada's equal opportunity here, like ours there, must be genuine and real, and not merely one of form: Formally and facially neutral regulations that are nevertheless intended to and do in effect limit "competition on the merits" from Canadian energy imports, while protecting their American counterparts, violate the Agreement.

For example, a quota or volumetric limitation on Canadian gas imports, imposed by a U.S. gas pipeline as an ostensible "operational restriction" on contract carriage gas and enforced by onerous rate or certificate terms, would violate the Agreement's anti-import quota provisions if (1) the restriction was not needed for genuine physical operating reasons and (2) the intent and effect of the quota is to prevent competition from cheaper Canadian gas that might, for example, lower the pipeline's takes of U.S. gas and raise its take-or-pay liability.

In such a case, an explicit statement that the goal of the quota (and the ancillary terms) is to discriminate against Canadian energy is of course not required for a violation of the Agreement to be demonstrated, and may be inferred by the FERC or any other agency.

In sum, U.S. Federal and State agencies are to "look behind" the surface terms of a contract, rate filing, or certificate requiring their approval, in order to ensure genuine compliance with the Agreement, the implementing bill, and the Statement of Administration Action. Otherwise, its benefits for U.S. consumers and energy security could not be fully achieved.

Electricity

No Amendment To Existing Law.—Chapter Nine of the Agreement requires no change in the Federal Power Act (FPA), the Public Utility Regulatory Polices Act of 1978 (PURPA), or any other federal law in order to implement the Agreement. In other words, the existing Federal laws governing electricity are consistent with the Agreement.

Provisions in Statement of Administrative Action Governing Bonneville Power Administration.—Annex 905.2 of the Agreement raises two issues concerning the Bonneville Power Administration (BPA) and British Columbia Hydro (BC Hydro), neither of which required implementing legislation and both of which are addressed in the Statement of Administrative Action. Those issues are the following:

(1) Paragraph 2. of Annex 905.2 states that the United States shall "cause [BPA] to modify its Intertie Access Policy so as to afford British Columbia Hydro treatment no less favourable than the most favourable treatment afforded to utilities located outside the Pacific Northwest." As amplified in the Statement of Administrative Action, this provision takes no position on the ongoing dispute between BPA and California utilities as to "the legality or appropriateness of BPA's policy of providing priority intertie access

to Pacific Northwest region." Nor does the Agreement alter the existing laws pursuant to which BPA's Intertie Access Policy as developed. Rather, the Agreement and accompanying Statement clarify the fact that BPA must afford to electricity produced by BC Hydro treatment "no less favourable" than the treatment it affords to electricity produced by non-Pacific Northwest utilities (including California utilities).

(2) Paragraph 5. of Annex 905.2 states that "[t]he Parties fully expect the [BPA] and British Columbia Hydro will continue to negotiate mutually beneficial arrangements consistent with the objectives of this Agreement." As clarified in the Statement of Administrative Action, this provision requires no specific negotiations either to commence or to continue. Nor does this provision either require or preclude the incusion of other parties (such as utilities in California and/or the Pacific Northwest) in whatever negotiations between BPA, BC Hydro, and utilities in California and the Pacific Northwest, "[w]hen and where appropriate," to "negotiate mutually beneficial arrangements consistent with the objectives of the Agreement and applicable laws including energy, safety and environmental laws."

Discrimination Based on National Origin.—The Statement of Administrative Action clarifies that "[t]he Agreement precludes discrimination, based solely on national origin, by ERA or FERC against imports of electricity, or any class of imports of electricity, from Canada." This means that the importation of Canadian electricity, or Canada's access to American electricity markets, cannot be limited by reasons of the origin of that electricity.

Neither the Agreement, nor the Public Utility Regulatory Policies Act of 1978, nor the Federal Power Act grants to ERA or to FERC the authority to exclude Canadian electricity from competitive bidding processes for the purchase and sale of electricity or, in turn, the authority to delegate such exclusionary power to state regulatory authorities or to nonregulated utilities.

Uranium

The uranium provisions of the Agreement will preclude the DOE from ever prohibiting the enrichment of Canadian-origin uranium for use in domestic nuclear power plants. Under current law, the Department would be required to prohibit the enrichment of foreign uranium to the extent necessary to maintain the viability of the domestic uranium industry.

The Agreement also requires Canada to remove requirements that Canadian-origin uranium destined for use in the United States be processed in Canada. Thus, a utility in the United States could purchase uranium in Canada and choose to have it processed in the United States.

Alaskan Oil

To illustrate the types of export transactions contemplated by the implementing legislation, and help to rapidly commence the authorized exports, the following examples of permissible exports are set forth:

A producer of Alaska North Slope (ANS) crude oil agrees to supply a Canadian refinery up to 50,000 barrels per day of ANS

crude. The crude will be transported from the producing field via the Trans-Alaskan Pipeline and loaded onto vessels documented under section 12106 of title 46, United States Code. The vessels will transport the crude to a port or place near the Canadian refinery's crude oil storage facilities. In the event that dock facilities are inadequate for the purpose of off-loading the crude directly from the vessel, the crude will be lightered from the vessel to the port facilities via barges. In this case, the barges engaged in lightering operations are not considered "ocean transportation" and as such shall not be subject to the requirement for documentation under 46 U.S.C. 12106.

It is the intent of the Committee that the above transaction would not be subject to the requirements of section 7(d)(2) of the Act. Nor would the exports be in any way constrained by any limitation on the export of refined petroleum products. The exports may be direct sales and no exchange for Canadian or any other crude is required.

The Committee endorses, and wishes to emphasize, the provision in the Statement of Administrative Action stipulating that the Commerce Department shall:

> * * * ensure that, in authorizing exports by different applicants for the 50,000 barrels per day allowance, a streamlined, simple, fair and nondiscriminatory process is used, such as, for example, a first-come, first-served basis.

Further, the Committee believes that it is in the spirit of the Agreement that the Commerce Department act expeditiously in amending the Export Administration Regulations and that the administration generally comply with the Alaska Oil Exports section of the Statement of Administrative Action in a timely fashion shortly after entry into force of the Agreement.

Natural Gas

No amendment to existing law.—Chapter Nine of the Agreement requires no change in the Natural Gas Act (NGA), the Natural Gas Policy Act (NGPA), or any other federal natural gas law in order to implement the Agreement.

This means that, under section 102(a) of this implementing legislation, these existing Federal natural gas laws are consistent with the Agreement.

There are several reasons for this: First, none of these laws specify different price or non-price regulation for Canadian gas as opposed to U.S. gas.

Second, both the NGA and the NGPA bar discrimination and preferential treatment, and affirmatively require nondiscriminatory rates and charges for the interstate shipment and sale of natural gas.

Third, other provisions of these laws mandate "just and reasonable" treatment and bar gas companies from subjecting "any person" to any prejudice or disadvantage. These standards are entirely consistent with the Agreement.

Fourth, the NGPA embodies a basic policy of relying on free market forces and increased competition to determine levels of production, consumption, and price. The Agreement expands that reli-

ance and increases that competition, and is thus consistent with the NGPA.

Fifth, natural gas licensing, import, and export decisions by FERC and DOE's ERA have, under the Natural Gas Act, long been decided on the basis of "public interest" and "public convenience" standards. The Agreement's basic policy of free natural gas trade with Canada—and the force of law which the Agreement carries—now become additional factors which these agencies must consider as they make decisions under these "public interest" standards.

Opinion 256.—One concern for U.S. gas producers involves FERC's Opinion No. 256, the so-called "as billed" decision on pipeline rates.

In this decision, which is currently on appeal, FERC considered the rates of certain U.S. gas pipelines: Specifically, could these pipelines charge their customers in the same way that they were charged (or billed) by their suppliers?

The suppliers of the U.S. pipelines stretched northward in a chain of middlemen that ended with Canadian gas producers in Alberta. In order to increase their U.S. sales volumes while maintaining the sales price of those same volumes, the Canadian producers had lowered their "per-thousand-cubic-feet" price to U.S. buyers—the pipelines—while raising their flat monthly charge.

This combination of lower variable charges and higher fixed charges would keep total Canadian earnings unchanged for any given volume of gas exports to the U.S.A. (In the gas industry's jargon, the lower "commodity charge" is made up for by the higher "demand charge.")

However, the lower variable charge proposed by the Canadians could at the same time make their gas more attractive to U.S. buyers, who in many cases only consider variable and not fixed charges when making their purchasing decisions. That in turn ultimately means increased sales for canadian producers and lower sales for U.S. producers.

In Opinion 256, the FERC decided that the U.S. pipelines could not pass through to their buyers—such as local gas utilities—a combination of variable and fixed charges determined under different assumptions and rules for Canadian gas as opposed to American gas. Instead, FERC allowed pipeline passthrough if the same allocation rules were used for Canadian as for American gas.

The Committee believes that different rules are not equitable here. Producers from either nation could gain an artificial advantage over producers from the other, if one group "put everything in the demand charge" while the other group didn't. Regulation of U.S. pipelines that buy from both sets of producers must treat them evenly, as FERC has done in Opinion 256.

The Agreement does not overturn Opinion 256.—The Agreement and the implementing legislation do not and cannot displace the Court of Appeals which is currently reviewing this opinion under the NGA. However, FERC's decision is in the Committee's view consistent with the Agreement, and is not overturned by the agreement and the implementing legislation.

First, the opinion provides the same "downstream pipeline" treatment for all gas sold in the United States, regardless of the nation in which it was originally produced. Rulings that treat all

producers evenly and equally in this type of nondiscriminatory fashion, clearly are the goal of the Agreement.

Second, the Canadian government itself has agreed that Opinion 256 is not inconsistent with the Agreement.

It is true, that—if upheld—Opinion No. 256 has the effect of lowering the profits Canadian producers anticipated earning before the opinion was decided.

But many FERC opinions have had this effect on U.S. producers and pipelines, too, and it is in any event impossible to guarantee the profit expectations of all competing businessmen in the gas industry while simultaneously continuing to regulate the gas industry under existing laws.

In fact, the negotiators of the Agreement specifically rejected language that would make international gas contracts more untouchable, privileged, or sanctified than domestic contracts.

Such an untenable approach, though it could have spared Canadian producers from the financially adverse impact of the opinion, would be unfair to producers and consumers in both nations: A sale from Alberta to Illinois would have preferential legal status over a sale from Alberta to Toronto, and over a sale from Texas to Illinois; and special legal treatment on the basis of nationality would be accorded, in violation of the Agreement.

Must Opinion 256 Be Extended.—Different issues are raised by requests that Opinion 256 be extended—or not be extended—to other parties, other importers, and other cases that were not before the FERC when it decided that dispute.

In particular, the Agreement of course does not specifically require or forbid the decision's extension to new or different proceedings.

This is a question for the FERC or the ERA to decide, acting in accord with applicable law, including both the Natural Gas Act and this Agreement. Both agencies have broad discretion to adhere to old policies or adopt new ones. This is a familiar part of the administrative law process, and a part of these agencies' authority which is not taken away by the Agreement or this implementing legislation.

It is not appropriate—especially in the context of this measure which does not change existing gas laws—to specify the outcomes of pending, unargued cases, and thereby in effect displace the FERC or the ERA.

Consistency With Order 500.—Others are concerned that the Agreement may require changes in FERC Order 500, relating to contract carriage transportation.

Again, Order 500 sets general rules and gives general rights to all producers who transport gas on U.S. pipelines, regardless of their nationality. Like Opinion 256, Order 500 is not final, and the courts will have the last word.

However, in the Committee's opinion, nothing in Order 500 seems inconsistent with the Agreement. Similarly, the Agreement does not in some way "lock in" Order 500 exactly in its current form—or otherwise in the future prevent FERC from revising it (or any other rule or order), so long as it continues to give Canadians and Americans equal, nondiscriminatory treatment.

Postage Stamp Rates.—Such rates are another example of a FERC power to set or allow rates in a way that *could* illegally violate the Agreement and the nondiscrimination provisions of the Natural Gas Act.

These rates are typically used on "cobweb" or "grid" pipelines networks with multiple entry and exit points that move much gas by displacement, so that it is difficult to say just how far each producer's specific volumes of gas have traveled. The regulatory cost of calculating different charges for each producer—with "long haul" shippers paying commensurately more than "short hop" shippers—can be excessive, and the task nearly impossible.

Nevertheless, in a proper case FERC could find that such rates have been used to penalize short hop Canadian producers, by making them pay as much as longer haul American shippers. FERC could properly find this to violate the Natural Gas Act or the Agreement.

But whether unjust postage stamp rates have in fact been set by pipelines or wrongly allowed by the FERC, would have to be answered under the same FERC and appellate processes that are now open to Americans as well as Canadians. Again, FERC retains all its broad policy powers over rate design, but cannot have different rules for American and Canadian petitioners.

Provincial "First Use" Export Taxes.—The Agreement would apply in Canadian producing provinces, for example in Alberta, to nullify a tax such as the so-called "first use tax" like that enacted in the 1970's by Louisiana.

That tax was imposed on all "first users" of natural gas, and users within the state were then wholly exempted. The effect was identical to that of an export tax: Only consumers outside of the state of production paid the tax.

This Agreement applies to both states and provinces, as well as to the two Federal Governments. It prevents both countries, and their governmental subunits, from taxing the export of an energy good to the other country, unless the same tax is charged on that energy when it is destined for domestic consumption in that nation, state, or province.

Ban on Discriminatory Public Utility Regulation in Canada

Under the Agreement, Canadian gas (and electricity) in Canada that is destined for United States consumption must be treated exactly like Canadian gas in Canada that is destined for Canadian consumption.

As the Statement of Administrative Action notes, tariffs, rates, certificates, permits, or other Federal or provincial governmental approvals cannot differ in their economic, regulatory, or legal treatment of gas (or electricity) passing through a particular segment of the heavily regulated gas (or electric) transmission systems in Canada, on the grounds that one shipment is ultimately destined for United States consumption, and the other for Canadian consumption.

Such a difference, whether explicit or tacit, would violate the Agreement, in particular, Article 903: This Article bans both nations from introducing or maintaining a "tax, duty, or charge" on

energy exports which is not also introduced or maintained on energy "when destined for domestic consumption."

Regulatory approval of enforcement by a government entity of a charge, rate, or term that is not equally applied in this fashion—even though set forth in the first instance in the tariff of a "private" pipeline (or "private" electric utility)—is covered by this Article.

Goods and services

Finally, while this Article covers "energy goods," both nations recognize that the price of energy goods at the border includes a substantial delivery, shipping, or transmission cost component, especially in the case of electricity and natural gas.

The bans on discrimination relating to trade in "energy goods" at the border thus incorporate and includes equivalent bans against discrimination in the kinds of transportation and transmission services that are required to get these goods to the border, and that make up an inherent and significant portion of their border price.

CHAPTER FOURTEEN: SERVICES

The Agreement covers a broad range of services including insurance, construction services, real estate services, mining and metal services, and agricultural and forestry services. In addition, the Agreement covers financial services and investment. The negotiations on the general services agreement were conducted separately from the negotiations on financial services and investment.

United States-Canadian bilateral trade in services has been growing steadily. United States-Canadian total bilateral trade in services reached $11 billion in 1986, with the United States achieving a $2.3 billion surplus in services trade in that year. For 1987, the U.S. services surplus rose still higher to $4 billion.

The services negotiations had two goals: to establish rules to guide future government policy concerning the provision of covered services by United States or Canadian nationals, and to rollback existing barriers to trade in certain covered services sectors.

The Agreement's greatest accomplishment in the services area is that it imposes a standstill which commits both countries not to impose any new regulations or laws that discriminate against services provided by United States and Canadian interests in either country. No existing law or regulation, or amendment thereto or extension thereof, is required to be changed in any way by the Agreement. Instead, the Agreement only commits the two countries to seek to negotiate the removal or modification of existing laws or regulations that discriminate against United States and Canadian service providers.

The Agreement sets out obligations that both the United States and Canada must comply with in the services area:

National treatment, to prohibit discrimination against foreign service providers;

Right of Establishment, to guarantee appropriate market access;

Licensing and Certification procedures that are designed to eliminate any differential treatment of either United States or Canadian parties for purposes of licensing and certification.

Prospective rollback of existing restrictions that have been grandfathered by the Agreement.

The Agreement raises a unique and important issue regarding insurance. Although the Agreement does not require either the United States or Canada to change existing laws or regulations affecting insurance and other services, the Agreement does require each country to prohibit the introduction of new laws or regulations that would treat the providers of insurance services of the other country differently than domestic providers.

In the United States where insurance is regulated at the state level, such as prohibition against unequal treatment can only be accomplished through a preemptive federal statute applying to all the states. As a result, section 101 of the implementing legislation clearly states that the provisions of the Agreement prevail over any conflicting state law, including any state law regulating or taxing the business of insurance.

CHAPTER SIXTEEN: INVESTMENT

Summary of FTA Provisions

Chapter Sixteen of the Agreement provides that future legislation and regulations in both countries must accord investors of the other country treatment that is no less favorable than the most favorable treatment it accords in like circumstances to domestic investors, under the principle of "national treatment." This provision applies to state, local and provincial governments. Most existing investment legislation is "grandfathered," including Canadian restrictions on foreign investment in the communications and energy fields.

Major disputes have arisen because of Canadian regulation of U.S. direct investment. Canada's strict investment policy has resulted from the imbalance in the level of bilateral investment and Canadian concern about the influx of foreign direct investment that occurred in the 1950's and 1960's. In the early 1970's, about three-fifths of the manufacturing and mining industries and three-quarters of the petroleum industry in Canada were foreign-owned, principally by U.S. firms. The value of U.S. direct investment in Canada was about ten times the value of Canadian direct investment in the United States.

These figures have changed drastically in recent years. From 1982 through 1986, Canadian direct investment in the United States grew by 56.4 percent, while United States investment in Canada expanded by only 15.3 percent. Most of the Canadian growth was in other private investment, including banking, finance, and real estate, which almost doubled to US$10 billion at the end of 1986. On the other hand, most U.S. growth was in investment in Canadian manufacturing.

The Agreement deals with investment issues in the same way it handles services issues. All existing restrictions affecting foreign investment are grandfathered, whereas future laws and regulations must treat both United States and Canadian investment in a com-

parable way. The Agreement covers only direct investment *(i.e.,* investment in goods producing activities and services activities); however, both transportation services and cultural industries *(e.g.,* publishing firms and film production) are excluded from coverage under the Agreement.

The Agreement commits both countries to provide equal treatment in the future investment policies for U.S. and Candian investment for the purpose of establishing a new business, operating a business, and acquiring or selling a business, subject to the Agreement. Canada will still be able to screen direct investment under its Investment Canada Act. Screening of indirect investment *(e.g.,* investment in stock equities) is to be phased out over three years. Additionally, the threshold for screnning direct investment will be increased from its present level, C$5 million, to C$150 million by 1992.

The Agreement strictly prohibits either the United States or Canada from imposing performance requirements, such as domestic content and import substitution, on investment that affects trade with the other country. And, the investment provisions are subject to the general dispute settlement provision of the Agreement, which is binding, except as it may relate to transportation and cultural industries.

The retention of the screening privilege by Investment Canada means that conditions similar to those facing U.S. energy companies in 1980–81 may exist in Canada. Canadian companies can luanch hostile takeovers of U.S. companies and be protected against a counteroffensive from the U.S. targeted company because the Agreement permits Canada to defend its firm by continuing to screen investment.

Given our country's historical leadership in the effort to reduce international investment barriers, the Committee is disappointed that the Administration was not more successful in getting Canada to eliminate its very restrictive policies for the screening, review and approval of foreign direct investment. The U.S., on the other hand, currently restricts foreign direct investment only for reasons of national security.

There is no restrictive policy in the United States that corresponds with the broader policy that continues to exist under the Agreement in Canada—and none, to our knowledge, is under consideration. That disparity is important because it places this country at a competitive disadvantage vis-a-vis Canada. The objective should be to open our borders fully, not continue such restrictive policies.

Furthermore, the Agreement does not ban many performance requirements, such as technology transfer and licensing requirements, which Canada can still require of U.S. firms seeking to make direct investments in Canada. The continuation of such requirements will distort trade and employment patterns in North America. We are asking our General Agreement on Tariffs and Trade (GATT) partners to eliminate these practices through our multilateral negotiations. Developing countries will likely view our position in the Canadian Free Trade Agreement to be inconsistent with our position at the GATT level.

Finally, the Agreement would leave unchanged Canadian authority under which foreign investors may be forced to divest themselves of Canadian publishing or film distribution firms that are acquired either through direct or indirect means. Here again, the United States is accepting a Canadian practice that contradicts the position we have taken internationally. These divestitures can occur with only a guarantee that foreign investors be paid a "fair price", and they are not restricted to the "public purpose" standard we have advocated in other agreements. In this case like the case of performance requirements we are sending a message that Canada is an exception to principals we have asked developing nations and our GATT partners to accept.

There is a Canadian divestiture case taking place right now. Two years ago, Canada rules that Gulf and Western could temporarily retain its acquisition of the publishing firm of Prentice Hall of Canada because that purchase had been started before Canada's policy of no foreign ownership of "cultural industries" (publishing and film distributors) was announced. But, the Canadian Government said Gulf and Western would have to divest itself of a textbook publishing company, Ginn, which was a subsidiary of Prentice-Hall within the next two years. The 2 years are now up and Gulf says it has been unable to find an acceptable buyer. As a result, Canada has announced that it plans to expropriate Ginn. Negotiations between the Canadian government and Gulf and Western are continuing.

Actions Required or Appropriate To Implement the FTA

The Statement of Administrative Action states that Chapter Sixteen does not affect existing U.S. laws or other measures, and therefore, no regulatory or legislative changes are required. The Statement clarifies that provisions of existing law that might otherwise raise questions of compliance, such as provisions of the Atomic Energy Act preventing the issuance of licenses to foreign corporations, are "grandfathered" by Article 1607.

As noted in the Statement of Administrative Action, the oil, gas and uranium industries are exempt from required amendments of the investment Canada Act, and will be subject to the policies described in an exchange of letters. As stated by the Administration (letter of May 27, 1988 from Clayton Yeutter to John D. Dingell), "[t]hese letters do not constitute U.S. "approval" of Canadian investment restrictions in this or any other area."

The implementing bill in subsection 304(a) authorizes the President to negotiate an agreement with Canada on the liberalization of investment rules. Subsection 304(b)(2) establishes the objectives of future negotiations on such liberalization, including, inter alia, the extension of principles of the Agreement to energy and cultural industries, to the extent they are not currently covered by the Agreement. The Committee intends this provision to be pursued vigorously to provide a level playing field in the investment field between the U.S. and Canada. The Committee also expects to be consulted regarding negotiations with Canada on these matters in accordance with the principles of "fast track" consideration under section 102(e) of the implementing bill.

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CHAPTER SEVENTEEN: FINANCIAL SERVICES

Summary of FTA Provisions

Chapter Seventeen of the Agreement covers current and future laws, regulations, and practices concerning financial institutions in both countries. It removes most existing barriers to U.S. financial institutions operating in Canada. Canadian financial institutions are guaranteed the open access they currently enjoy under existing U.S. law, and will benefit in the future from being accorded treatment no less favorable than that accorded on October 4, 1987, in their ability to establish and operate outside Canada. (Financial institutions include commercial banks, investment banks, trust and loan/savings and loan institutions, and certain activities of insurance companies.)

The United States and Canada have had substantial trade in financial services. For example, at the end of 1985, Canadian bank assets in the United States totalled about US$40 billion; there were also seventeen subsidiaries of U.S. banks and four representative offices in Canada with total assets of about C$11.8 billion. In addition, there are 19 Canadian firms or subsidiaries that are members of U.S. stock exchanges; four U.S. firms are currently registered with the Ontario Securities Commission, and several other U.S. firms own a minority stake in Canadian securities dealers.

In recent years, substantial deregulation of the Canadian financial market has occurred. There has already been a significant integration of the Canadian banking and securities industry. The five leading banks have acquired holdings in securities firms; foreign banks also have increased their participation in those firms subject to prescribed limits.

In most respects, the financial services part of the agreement continues the trend towards deregulation in financial markets that both governments have pursued. Both governments commit to liberalize their financial markets, to extend the resulting benefits to the firms of the other country, and to establish a consultative mechanism to oversee the liberalization. As with the entire financial services pact, the consultative mechansim is not subject to the dispute settlement provisions of the Free Trade Agreement, and is to be administered by the U.S. Treasury and the Canadian Department of Finance. There are no provisions regarding financial services regulatory policies at the state or provincial level, as there are under the other services portion of the Agreement.

In summary, the Agreement will free U.S.-owned banks and other financial institutions operating in Canada from most of the current restrictions on market share, asset growth, and capital expansion imposed against foreign firms. U.S. commercial bank subsidiaries will no longer be subject to the 16 percent ceiling set by the Bank Act on the foreign bank share of the total domestic assets of all banks in Canada, and restrictions on the establishment of branches by certain U.S.-owned banks will be removed. National treatment will be accorded to new applications from U.S. commercial banks to enter the Canadian market. In addition, the so-called "10/25 rule," which had limited total foreign participation in the largest Canadian banks to 25 percent, will be dropped for U.S. nationals or firms. However, the 10 percent ceiling for individual

holdings regardless of nationality will still remain, for these banks. Ownership restrictions are also being eliminated for insurance, trust, and loan companies, allowing U.S. firms to diversify by establishing or acquiring federally regulated insurance and trust companies.

The Agreement protects the right of Canadian banks to retain the multi-state branches grandfathered under the International Banking Act of 1978. The Agreement also provides national treatment for Canadian financial institutions under prospective amendments to the Glass-Steagall Act.

Further, the Agreement states that both parties agree to seek further unspecified liberalization of their markets and to extend the benefits to the other side. The Committee has an interest in, and expects to be informed about what such possible liberalization will entail.

Action Required or Appropriate to Implement FTA

Article 1702 of the Agreement is implemented by section 308 or H.R. 5090, which amends section 16 of the Banking Act of 1933 by adding a provision that would allow U.S. and foreign banks in the U.S. to underwrite and deal in Canadian-backed debt securities to thes same extent allowed for dealings in U.S.-backed securities. The Statement of Administrative Action states that the Comptroller of the Currency's Investment Securities Regulation (12 C.F.R. Part 1) with be amended to reflect this statutory change.

The Statement of Administrative Action further states that the Agreement does not accord independent legal authority for banking organizations to provide insurance services. The Committee intends that the term "banking organization" includes any bank holding company, any bank chartered under federal or state law, any foreign bank, or any branch, subsidiary or affiliate of any such bank or company. In the view of the Committee, nothing in the Agreement, implementing legislation, or Statement of Administrative Action provides any independent legal authority for banking institutions to underwrite or deal in securities other than Canadian government-backed debt securities.

CHAPTER EIGHTEEN: INSTITUTIONAL PROVISIONS

Under the Agreement, disputes which arise under both the Free Trade Agreement and the GATT, as well as agreements negotiated under the GATT, (except disputes under the Free Trade Agreement involving financial services and antidumping and countervailing duty cases) may be settled by the binational commission established by the Free Trade Agreement or under the GATT dispute resolution process.

The binational commission would be headed by the cabinet-level trade officers of the two countries. Representatives of both countries would be on the Commission. Provision is made that the Commission should meet at least annually, as well for notification and consultations of the parties.

If consultations fail to resolve disputes, provision is made that either party may request a formal meeting of the Commission. If a dispute still cannot be resolved, provision is made for submitting

the matter to binding arbitration. If either party fails to implement findings of a binding arbitration panel, the other party is free to suspend the application of equivalent benefits of the Agreement to the other party.

CHAPTER TWENTY: OTHER PROVISIONS

Summary of FTA Provisions

Chapter Twenty of the Agreement contains a number of miscellaneous provisions including provisions on cultural industries, copyright protection for broadcast signals, and monopolies. Article 2004 states that the Parties shall cooperate in the Uruguay Round of multilateral trade negotiations to improve protection of intellectual property. Article 2005 generally exempts cultural industries from the terms of the Agreement. However, it allows measures of equivalent commerical effect in response to actions otherwise inconsistent with the Agreement. It is assumed that such measures would be appropriate to allow the U.S. to retaliate against Canadian subsidies or other forms of assistance to Canadian cultural industries.

The Motion Picture Association has encountered significant problems in receiving authority to distribute films in Canada. First, Canada's Minister of Communications and Culture announced last year that Canada would implement legislation to restrict the distribution of American movies, television and home video material in Canada. Although this threat has not yet been carried out, Canada has denied the Walt Disney Company the right to establish a distribution office in Canada. The status of Twentieth Century Fox's distribution office is also being reviewed.

Furthermore, at Canada's insistence, film, television and home video were not covered by the Free Trade Agreement—they were included under the Agreement's exemption of "cultural industries". As a result, the U.S. film industry has been trying to work out a solution to its problem outside the Agreement.

So far, this effort has failed. Canada is trying to force the U.S. industry to distribute its films and videos through Canadian distributors so that Canadian, rather than American films can be promoted. Under this requirement, U.S. distributors would be required to obtain a license before they could distribute films in Canada. Of all the other free world countries that U.S. films are distributed in, only Switzerland has a licensing requirement like Canada wants to impose.

The Motion Picture Association of America (MPAA) believes it is important to resist Canada's licensing proposal, not only because of the importance of Canada's market, but also because of the precedent it would set for other markets where MPAA is fighting such proposals. MPAA points out that 38 percent of all U.S. film, television and home video revenues come from foreign markets. Annually, the U.S. film industry cannot survive if restrictive practices, like Canada is proposing, begin to be applied.

The United States was not successful in its efforts on behalf of the U.S. film industry. The implementing legislation, however, contains negotiating objectives regarding intellectual property which may result in future agreements dealing with the film industry's problems.

Article 2006 provides for copyright protection for broadcast signals used by cable systems for rebroadcast in areas where these signals would not otherwise be received. This will provide that owners of U.S. television programs should be compensated for retransmission of their programs in Canada. Canada retains the right to maintain Canadian content consistent with the "public good" *(e.g.,* restrictions on alcohol advertising). A joint advisory commission will be established to address other outstanding retransmission rights. It is expected that the commission will seek to further protect the retransmission rights of U.S. broadcasters.

Article 2010 permits both countries to retain or designate a monopoly provided it does not detrimentally affect the benefits of the Agreement. It also prohibits monopolies from anticompetitive practices such as cross subsidization, and predatory practices in the other country's market. It is expected that this provision will ensure greater market access in Canada for telecommunications hardware.

MISCELLANEOUS PROVISIONS

Government Procurement

The Committee notes, with regret, that the Agreement does not require the Government of Canada to change its preferential procurement policy for telecommunications equipment.

Under this policy, the Government of Canada purchases telecommunications equipment for its government-owned telecommunications system, from Northern Telecom, a Canadian-owned company, rather than putting its equipment needs out for competitive bid. As a result, U.S.-owned telecommunications manufacturers are denied a real opprtunity to compete for this business.

The Committee regrets that U.S.-owned manufacturers face this competitive disadvantage. It is our hope than an agreement can be reached in the future which will give U.S. telecommunications firms greater access to the Canadian market.

Hearings

The Committee's Subcommittee on Energy and Power held two days of hearings on provisions of the United States-Canada Free Trade Agreement on March 1 and 9, 1988. At the first hearing testimony was received from seven witnesses, representing the oil and natural gas industries. At the second hearing testimony was received from the Honorable William F. Martin, Deputy Secretary, U.S. Department of Energy; the Honorable Alan Holmer, Deputy U.S. Trade Representative (accompanied by Mr. Robert A. Reinstein); and three representatives of state government, power companies, and energy producers.

The Subcommittee on Commerce, Consumer Protection, and Competitiveness held three days of hearings on Provisions of the U.S.-Canada Free Trade Agreement on February 23, March 22, and April 26, 1988. At the first hearing testimony was received from the Honorable Bruce Smart, Under Secretary for International Trade, Department of Commerce; the Honorable Alan Holmer, Deputy U.S. Trade Representative; the Honorable Alexander B. Trowbridge, President, National Association of Manufacturers; and

eight representatives of business and industry, economists, and trade associations. At the second hearing testimony was received from three representatives of the Departments of Commerce and Treasury; Mr. Robert D. Hormats, Goldman Sachs International, Inc., New York City; and from three representatives of industry and public policy research. At the third hearing testimony was received from representatives of the Office of the U.S. Trade Representative; labor unions, manufacturers, and motion picture distributors.

Committee Consideration

H.R. 5090 was referred jointly to the Committee on Ways and Means; Agriculture; Banking, Finance and Urban Affairs; Energy and Commerce; Foreign Affairs; Government Operations; Interior and Insular Affairs and Judiciary. On August 2, 1988, the Committee on Energy and Commerce met in open session and ordered reported the bill H.R. 5090 without amendment by voice vote, a quorum being present.

Committee Oversight Findings

Pursuant to clause 2(l)(3)(A) of rule XI of the Rules of the House of Representatives, no oversight findings or recommendations have been made by the Committee.

Committee on Government Operations

Pursuant to clause 2(l)(3)(D) of rule XI of the Rules of the House of Representatives, no oversight findings have been submitted to the Committee by the Committee on Government Operations.

Committee Cost Estimate

In compliance with clause 7(a) of rule XIII of the Rules of the House of Representatives, the Committee believes that the bill will result in a net increase in the deficit of $103,000,000; $224,000,000; $309,000,000; $427,000,000; and $552,000,000 for fiscal years 1989–1993, respectively.

Congressional Budget Office Estimate

U.S. Congress,
Congressional Budget Office,
Washington, DC, August 3, 1988.

Hon. John D. Dingell,
Chairman, Committee on Energy and Commerce,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has reviewed H.R. 5090, the United States-Canada Free-Trade Agreement Implementation Act of 1988. The attached table represents the estimated budget impact of the bill, as ordered reported by the House Committee on Energy and Commerce, August 2, 1988.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Douglas Criscitello, who can be reached at 226-2850.

Sincerely,

JAMES L. BLUM,
Acting Director.

ESTIMATED COSTS TO THE FEDERAL GOVERNMENT TO IMPLEMENT THE UNITED STATES-CANADA FREE-TRADE AGREEMENT—H.R. 5090 AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON ENERGY AND COMMERCE, AUG. 2, 1988

[By fiscal year, in millions of dollars]

	1989	1990	1991	1992	1993
NET REVENUE EFFECTS					
Estimated revenues	−97	−198	−303	−421	−546
DIRECT SPENDING					
Commodity Credit Corporation:					
Estimated budget authority	2	2	3	4	4
Estimated outlays	2	2	3	4	4
Customs user fees:					
Estimated budget authority		22	1		
Estimated outlays		22	1		
Total direct spending:					
Estimated budget authority	2	24	4	4	4
Estimated outlays	2	24	4	4	4
AUTHORIZATIONS					
U.S. Secretariat:					
Estimated authorization Level	1	1	1	1	1
Estimated outlays	1	1	1	1	1
Binational panels and committees:					
Estimated authorization Level [1]	2				
Estimated outlays	2				
Other costs:					
Estimated authorization Level	1	1	1	1	1
Estimated outlays	1	1	1	1	1
Total authorizatiaons:					
Estimated authorization Level	4	2	2	2	2
Estimated outlays	4	2	2	2	2
Net increase in the deficit	103	224	309	427	552

[1] Costs of about $2 million a year for binational panels and committees would be expected to continue in years after 1989, but the bill only authorizes appropriations for fiscal year 1989.

INFLATIONARY IMPACT STATEMENT

Pursuant to clause 2(l)(4) of rule XI of the Rules of the House of Representatives, the Committee makes the following statement with regard to the inflationary impact of the reported bill:

The Committee believes that H.R. 5090 will have no inflationary impact.

SECTION-BY-SECTION ANALYSIS

Sec. 1—Short Title and Table of Contents

Section 1 provides that this Act may be referred to as the "United States-Canada Free-Trade Agreement Implementation Act of 1988."

Sec. 2—Purposes

Section 2 identifies the purposes of this Act, which include:

(1) to approve and implement the Free-Trade Agreement between the United States and Canada negotiated under the authority of section 102 of the Trade Act of 1974;

(2) to strengthen and develop economic relations between the United States and Canada for their mutual benefit;

(3) to establish a free-trade area between the two nations through the reduction and elimination of barriers to trade in goods and services and to investment; and

(4) to lay the foundation for further cooperation to expand and enhance the benefits of such Agreement.

TITLE I—APPROVAL OF UNITED STATES-CANADA FREE-TRADE AGREEMENT AND RELATIONSHIP OF AGREEMENT TO UNITED STATES LAW

Sec. 101—Approval of United States-Canada Free-Trade Agreement

Section 101 provides that the Congress approves the United States-Canada Free-Trade Agreement, accompanying side letters exchanged between the two countries, and the statement of administrative action. In addition, it authorizes the President to enter the Agreement into force, on or after January 1, 1989, by an exchange of letters with the Government of Canada, when he determines that Canada has taken measures necessary to comply with the obligations of the Agreement. Finally, it provides that the U.S. Trade Representative shall submit a report to Congress, within 60 days after the date of enactment (but not later than December 15, 1988), identifying Canadian practices that are not in conformity with the Agreement and that require a change of Canadian law, regulation, policy or practice to bring Canada in compliance with the Agreement.

Sec. 102—Relationship of the Agreement to United States Law

Section 102 provides that federal law shall prevail over the Agreement; but that the Agreement shall prevail over conflicting state and local law, including any state law regulating or taxing the business of insurance. This provision makes clear that the requirements of the Agreement shall preempt future state laws regulating or taxing the business of insurance. This federal preemption authority is necessary because the business of insurance is regulated at the state, not the federal, level. If it were not for this preemptive authority, the United State could not ensure that its obligations, under the Agreement, to prohibit discriminatory treatment of Canadian insurance firms in the future would be fulfilled.

Section 102(c) of the implementing bill bars private causes of action or defenses based on the Agreement. The Statement of Administrative Action further specifies that this provision also precludes a private right of action attempting to preclude or modify Federal action under statutes—such as the Natural Gas Act, for example—which have general discretionary "public interest" or "public convenience" standards.

Thus, a private litigant could not challenge a pipeline certificate application, for example, on the grounds that (1) it violates the Agreement, (2) the Agreement has the force of law and thus the

application violates the law, (3) therefore the application does not satisfy the "public convenience and necessity," and (4) therefore it violates the Natural Gas Act and must be denied.

However, as the Statement of Administrative Action also notes, this provision does *not* preclude "any agency" from considering or entertaining argument on whether its action or its proposed action is consistent with the Free Trade Agreement.

For several reasons, the Committee intends that agencies such as the FERC, the DOE, and the Departments of Commerce and Transportation give a liberal construction to this provision of the Statement:

—The Agreement does have the force of law, and allegations of violations deserve careful consideration.

—As previously noted, violations can be covert or subtle as well as explicit, and the views and analysis of private litigants may be essential for a reasoned determination by the agency on whether or not its approval or decision violates the Agreement.

—Federal and state agencies—unlike private parties—are bound to uphold the Agreement, on the basis of a fair and full record.

—Independently of section 102(c) of the implementing bill, other Federal judicial review statutes which are not altered or affected by this measure do prohibit FERC or ERA decisions that violate the Agreement. See, for example, 5 U.S.C. section 706(a)(A): "The reviewing court shall * * * hold unlawful and set aside agency action, findings and conclusions found to be—(A) arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law * * *."

In sum, FERC and ERA should be as ready to "consider and entertain argument" on claimed violations of the Agreement as on other legal matters. See also 5 U.S.C. 553(e), requiring all agencies to give rights of petition to any interested person.

Section 102(d) provides that to the extent possible, federal regulations necessary to implement obligations under the Agreement are to be developed and promulgated within one year.

This section provides also that the President has 30 months after the month in which the Agreement takes effect to submit legislation under the "fast-track" procedure making any change in federal law determined to be needed to enable the U.S. to fully implement its obligations under the Agreement.

Sec. 103—Consultation and Lay-over Requirements for, and Effective Date of, Proclaimed Actions

Section 103 sets out conditions, including layover requirements, under which the President may utilize authority in this Act to implement actions by proclamation.

Sec. 104—Harmonized System

Section 104 provides for the United States to implement the nomenclature system established under the International Convention on the Harmonized Commodity Description and Coding System.

Sec. 105—Implementing Actions in Anticipation of Entry into Force

Section 105 allows the President and agencies of the Government to proclaim and issue necessary actions and regulations to ensure

implementation of the Agreement on the date of enactment, provided that no such action or regulation would be effective earlier than the date on which the Agreement enters into force.

TITLE III—APPLICATION OF AGREEMENT TO SECTORS AND SERVICES

Sec. 305(a)—Alaskan Oil Exports

Section 305(a) exempts up to 50,000 barrels per day of Alaskan North Slope (ANS) crude oil from the export ban currently set forth in section 7(d)(1) of the Export Administrtion Act (EAA).

The goal is to allow the sale and export of this crude oil from American producers in Alaska to refiners and other buyers in Western Canada and other Canadian locations.

This provision reflects the fact that the Agreement is a two-way street: If Canada is agreeing to freely export its energy to the United States, as it is in this Agreement, then the United States should be willing to export its energy supplies to Canada in return. To do this, the EAA export ban must be partly lifted.

Lifting the ban will also benefit U.S. energy security: A shorter trip to western Canadian buyers means lower transportation costs to market for this portion of ANS crude; lower shipping costs mean a higher wellhead netback sales price for the oil producers/exporters in Alaska; a higher wellhead price means greater U.S. oil production; and that in turn means lower dependence on OPEC imports and greater energy security.

The provision requires that "ocean transportation" of the 50,000 barrels daily be on U.S. vessels; but "off-loading," lightering, or local barging to final destination need not be on U.S. vessels. Non-ocean transportation, for example, by pipeline from the United States to Canada, of course need not be on U.S. vessels.

Sec. 305(b)—Uranium Imports

Section 305(b) amends section 161v. of the Atomic Energy Act of 1954 to exclude source or special nuclear material originating from Canada from the term "foreign origin".

The DOE enriches uranium for domestic and foreign utilities. Section 161v. of the Atomic Energy Act of 1954 requires that the Department "to the extent necessary to assure the maintenance of a viable domestic uranium industry, shall not offer such services for source or special nuclear materials of foreign origin intended for use in a utilization facility within or under the jurisdiction of the United States."

The DOE currently does not restrict its enrichment services to domestic uranium. The effect of the provision will be to permanently preclude the Department from barring the enrichment of uranium originating in Canada.

Agency Views

The U.S. Trade Representative,
Executive Office of the President,
Washington, DC, July 8, 1988.

Hon. John Dingell,
Chairman, Committee on Energy and Commerce,
House of Representatives, Washington, DC.

Dear John: I am writing to follow up on our conversation today concerning our efforts to obtain the agreement of the Government of Canada to raise from 50 to 60 percent the rule of origin for autos and automotive goods under the Free Trade Agreement.

As you well know, we had no higher priority at the conclusion of these negotiations last fall than achievement of the 60 percent rule of origin for autos and automotive goods. But a meeting of the minds requires two minds to agree, and unfortunately the Government of Canada was not willing at that time to increase the rule from 50 to 60 percent except on terms that all concerned U.S. automotive interests advised us were unacceptable.

As I indicated over the telephone today, I gave it one last try yesterday in a long conversation with Trade Minister Crosbie. He says his government will not reconsider this issue now, although it is willing to examine it again with us in discussions next year.

I reaffirm our intention, John, to pursue this matter as a high priority. We very much want to increase the auto rule of origin to 60 percent, and will do everything possible to obtain Canadian agreement on satisfactory terms as early as possible next year.

Sincerely,

Clayton Yeutter.

U.S. House of Representatives,
Committee on Energy and Commerce,
Washington, DC, June 28, 1988.

Hon. James A. Baker III,
Secretary of the Treasury,
Department of the Treasury,
Washington, DC.

Hon. Clayton Yeutter,
U.S. Trade Representative,
Washington, DC.

Dear Secretary Baker and Ambassador Yeutter: Since meeting with a number of your deputies a few days ago, our staff has learned more about the history of U.S. policy development concerning the 50–60 percent content issue and about enforcement of the U.S.-Canadian Free Trade Agreement.

At our request, the Treasury Department provided our staff with a series of memoranda exchanged between the Customs Service and the Treasury Department. The Most recent memoranda are dated this month. The memoranda reveal that the Customs Service was obviously excluded from the Canadian-U.S. Free Trade Agreement negotiations and apparently was not informed or consulted to any meaningful degree during any of the stages of the negotiations.

Now Customs is trying to "catch up" and we are seeing rather acrimonious exchanges between Customs and Treasury officials. That is extremely troubling, particularly as we in Congress are debating the adequacy of the content issue and its meaning and the adequacy of future U.S. enforcement of the Agreement.

One comment emanating anonymously from Customs and addressed to our Committee is as follows:

> You people are missing the boat by not looking into these FTA rules of origin. They are an administrative, enforcement, and, most important, an economic disaster—a sop to the vertically integrated multi-nationals of the likes of IBM and Toshiba. Customs has been all but shut out from any effective role in the process of the past several months, and nervousness is developing over the day the FTA becomes a reality. Public statements from the Hill do not reflect an understanding of the economic and industrial realities of the Agreement.

Upon a further review of documents provided by the Commerce Department to our Oversight and Investigations Subcommittee and the General Accounting Office cocnerning the former Deputy Assistant Secretary for Automotive Affairs and Consumer Goods at the Commerce Department, it is equally troubling to learn that from May to September 1987 the Administration was still struggling internally over the Rule of Origin for the FTA in general and the percentage of preference for automotive products in particular. One document shows that, as late as September 1987 the 50 percent rule of preference for automotive products and retention of the Auto Pact remained "contentious within the U.S. Government" and was not yet "broached with the Canadians." Indeed, the documents show that as of that late date in the negotiations, the Treasury and State Departments still supported 35 percent for all products, while Commerce was finally favoring a 50 percent (not 60 percent) rule. One June 1987 document, in providing several options, listed a 65 percent rule as a third option that is "supported by most U.S. and Canadian automotive producers and unions" and that would "encourage domestic sourcing of parts by North American producers seeking eligibility for bilateral duty-free trade." In opposition to this third option, the document said that most "foreign owned manufacturers and perhaps some traditional manufacturers will not meet this requirement without purchasing more United States/Canadian parts and components." Of course, we always thought that such North American purchases were precisely the purpose of entering into the Agreement in the case of autos and negotiating for a higher percentage. In short, it was good for both countries.

These various documents continue to give us great pause about this Agreement which is shared by many of our congressional colleagues. It is a great concern to this Committee in its oversight capacity, although we fully agree that legislative changes in this area are likely to be within the jurisdiction of the Ways and Means Committee. We, of course, have jurisdiction over several provisions of the legislation.

Last Friday, Committee staff met with Customs and Treasury officials over the interpretation and enforcement issues. We have reviewed the draft language suggested for the Statement of Administrative Action regarding enforcement and consider it too vague and too weak, particularly in light of the Customs' concerns. The discussions did not lessen our concerns.

The history of the 50–60 percent content rule reinforces our concerns about the adequacy of informal commitments by the Administration to seek an increase of the percentage to at least 60 percent, absent any firm written commitment by the Administration and a commitment from Canada to enter into such negotiations as part of the "Blue Ribbon" panel process on a priority basis so that the 60 percent will be achieved early in 1989. Chairman Rostenkowski has similarly sought such real assurances. We strongly urge that through side letters or other means the assurances we all want are achieved quickly.

As to the Customs concerns and the enforcement issue, they are real and they need to be resolved. The exchange of memoranda between Customs and the Deputy Assistant Secretary regarding such issues as "constructive assembly" indicate an immediate need for explanation and clarification from both Customs and Treasury under the 50 percent rule, possible through an early hearing. In essence, we need to know what impact the new rules of origin will have on the definition of "substantial transformation" for purposes of both revenue collection and country of origin determinations.

Most important is the question of enforcement resources. Given the substitution of a 50 percent value added criteria for the traditional transformation determination, does Customs really have or expect to have the necessary resources to perform the new audit functions? As noted the other day, Customs has increased the number of personnel. However, we understand that last year there were still only 65 regulatory aduits worldwide. How many more audits will the FTA require and how frequent will they be? (We want to ensure that such audits will be done without pulling people from other investigations.) There is little in the proposed language for the Statement of Administrative Action that gives us a feeling of commitment by the Treasury Department and Customs (with Office of Management and Budget approval) that the needed audits will be performed on a sufficiently frequent basis to deter transshipment fraud and otherwise ensure compliance.

We strongly urge that both of you and Canada recognize the importance of these several concerns to consideration of the FTA in our Committee. We appreciate the efforts you have made to date. Nevertheless, more is needed now.

With best wishes.

Sincerely,

JOHN D. DINGELL,
Chairman, Committee on Energy and Commerce.

JAMES J. FLORIO,
Chairman, Subcommittee on Commerce, Consumer Protection, and Competitiveness.

U.S. House of Representatives,
Committee on Energy and Commerce,
Washington, DC, May 25, 1988.

Hon. James A. Baker III,
Secretary of the Treasury,
Washington, DC.

Dear Mr. Secretary: As you and Ambassador Yeutter know, our committee, pursuant to the Speaker's letter of May 12, 1988 to you and the Ambassador, have been working in a "cooperative effort" with Administration staff to develop implementing legislation concerning the Canada-U.S. Free Trade Agreement. As a matter of fact, our staff met this week with the staff of the Committee on Ways and Means with, I understand, some good results. Nevertheless, there still remains some very important issues for this Committee involving autos and energy that cause great concern and are affecting support, including mine, for this implementing legislation. As the enclosed article in the May 18, 1988 edition of the Journal of Commerce indicates, some "worry" that we may be moving too fast. That worry may be justified.

I observe that in the case of energy, the Administration appears to be trying to reach broad accommodations with the other body. While I applaud efforts procedurally to reach accommodations, I observe that the nature and scope of those accommodations are of deep concern and interest to this Committee, as noted by Subcommittee Chairman Sharp in the enclosed letter. Most importantly, I do not detect quite the same accommodating attitude toward the concerns that I share with other Members in the Committee and the House about the impacts on the U.S. automotive industry and its workers from the Agreement and the need to better address those concerns before implementing legislation is submitted to Congress.

Before discussing in detail those concerns, I take note of the enclosed questions from Senator Riegle and the Administration's responses concerning future Auto Pact companies in Canada. The responses, together with staff assurances from the Administration and a reported letter between the U.S. and Canada (which I have not yet seen although I have asked for all such letters in my enclosed letter), seem to provide reasonable assurance that Canada will not grant Auto Pact status to vehicle manufacturers, including joint ventures, sometime in the future. However, these responses, etc., are not a part of the "Draft Statement of Administrative Action" submitted by the Administration to our Committee. Clearly, that document needs to reflect fully these understandings and commitments. Our staff will work with yours in this regard. At the same time, I urge that the above referenced letters be provided the Committee.

Let me now turn to the specific areas of concern.

Limitation on Duty Remission Benefits

The Administration, in its testimony and its letters to Congress, including this Committee, has stressed that under the Agreement Canada "will terminate production-based duty remission programs not later than "January 1, 1996." I have no illusion that this termi-

nation will occur earlier than that date because, as the correspondence observes, that is the date specified in existing contracts between foreign companies and Canada. The Canadians have already said they do not want to renege on their "contractual obligations." Thus, these programs will undoubtedly last through 1995.

It is my understanding that the Agreement provides that the duty remission programs cannot be "enhanced, expanded, or extended." However, that is a very vague commitment because it is also my understanding that the U.S. really has no specific knowledge of the programs in Canada from which to establish a baseline. In a recent communication to me, Michigan officials commented:

> This fact takes on greater importance in light of the potential to expand capacity by the vehicle manufacturers in Canada who are to benefit from this program. According to the U.S. Department of commerce (Office of Automotive Industry Affairs), the publically announced capacity in units by 1990 of Honda (Alliston, ONT) is 80,000; Hyundai (Bromont, QUE) is 120,000, and; Toyota (Cambridge, ONT) is 50,000, based upon one shift. By adding another shift, the manufacturers could expand production and the benefits under the program. CAMI (Ingerson, ONT) has capacity for 200,000 units base on two shifts.
>
> * * * * *
>
> Judy Bellow, Chair of the 301 Committee at USTR, under questioning before the Senate Governmental Affairs Committee, stated that in the absence of definitive information about the duty remission programs, the U.S. government would be free to make "adverse conclusions" about the duty remission programs. The Canadian government has not substantively responded to the USTR's January 29, 1988, request for information about the production-based program. As a result, the Congress should be free to draw "adverse conclusions" from the public record.

I am not comfortable in relying on this "adverse conclusion" approach. I believe that the implementing legislation must address this problem directly. I have directed our staff to work with yours to develop an effective provision for ensuring that a baseline will be established. Your cooperation is appreciated.

Enforcement

In the Administration's correspondence with Congress, it is contended that the 50-percent rule of origin under the Agreement "is tougher than the 50-percent value added test currently applied under the Auto Pact to southbound trade." Ambassador Yeutter contends it is "better" because it "is based on the direct cost of materials and processing, excluding profits and costs, such as advertising and administrative overhead, that are not directly a part of the manufacturing process." Others appear to share the Administration's view. However, they, as well as Administration people we have talked with, indicate strongly that the so-called "tough" requirement will be toothless without effective audits and enforcement on a regular basis, not just every few years. Adequate measures must

be taken to ensure compliance with the requirement that a mininum percentage, whether 50 or 60 percent, of the materials and direct processing costs for automobiles and automobile parts, imported from Canada with a claim for tariff preference, be sourced in North America.

The Committee does not believe that at this time, the Administration has committed to taking the needed measures, such as appropriate staffing for the Customs Service, to ensure such compliance. We need to before understand your plans for enforcement and staffing in this regard and request that the Statement of Administrative Action clearly address this issue, together with a commitment therein for reporting every two years to Congress (beginning in March 1990) on the efforts taken by the Customs Service to ensure compliance, such as periodic audits, and on the results of these efforts.

Made in North America

Undoubtedly, the most difficult and contentious issue concerning automobiles and this Agreement relates to automotive goods which, I understand, constitute one-third of all United States-Canada trade. It is the issue of the North American content of vehicles crossing our border for distribution and sale in interstate commerce in the United States.

I am aware of Administrative efforts before January to increase the percentage and of the provisions adopted by my colleagues in other Committees to achieve that objective. I applaud them. But the bottom line is that under the 50-percent rule North American workers will be disadvantaged, while workers in foreign countries will be advantaged. That is clearly demonstrated by the following statement for the auto parts industry:

THE CASE FOR A 60-PERCENT AUTOMOTIVE RULE OF ORIGIN

The United States-Canada Free Trade Agreement gives duty free preferences to goods containing up to 50 percent foreign (i.e. not United States or Canadian) input. This rule should be changed so that duty free benefits are available only to automotive goods that have 60 percent North American content. The 10 percent difference would provide crucial benefits to the North American parts industry by giving foreign carmakers an incentive to buy high-value, technology-intensive U.S. parts.

At present, the many foreign-owned vehicle factories in North America tend to assemble cars and trucks using imported drive-trains and other advanced parts, and to acquire only lower-value items in North America. The FTA's 50-percent rule would not help change this pattern of parts acquisitions and would do little to increase sales of advanced North American parts.

A 60-percent rule, in contrast, would promote increased sales of such parts to new North American vehicle assemblers. It is difficult to assemble a vehicle containing 60-percent North American content without incorporating a greater number of advanced parts made in North America. Thus, if a 60-percent rule is adopted, foreign manufacturers seeking duty-free benefits under the FTA are

likely to increase their use of high-technology United States and Candian parts.

POSSIBLE COMPOSITION OF DUTY-FREE CAR

Third-country parts	North American parts
A. Under FTA 50-percent rule	
Engine, transmission/transaxle related subcomponents	Tires, bumpers, sheet-metal, seats, accessories.
B. Under proposed 60-percent rule	
Engine or transmission transaxle related subcomponents	Same as above: Engine or transmission/transaxle or related subcomponents.

The composition under the 50-percent rule in not advantageous to North American workers.

As noted earlier in this letter, there is linkage between the automotive and energy issues important to this legislation. Within reason, Chairman Sharp and I want to be helpful to the Administration and the Senators in the other body in helping to resolve satisfactorily the relevant energy issues. Although we have concerns as indicated by Chairman Sharp, we are also sympathetic to the Senate and Administration concerns. But Subcommittee Chairman Florio and I, as well as Chairman Sharp, are also concerned that all of these automotive issues, particularly the 50 percent rule, are resolved satisfactorily. The two issues are inextricably related.

I want to be supportive of the Agreement, including the relevant energy issues, but I also want to ensure a better opportunity for obtaining the 60 percent level. At the moment, I believe the legislation is not adequate in this regard. Better assurances are needed through a legislative provision to ensure that in the not too distant future the "North American content of new automotive products entered for sale and distribution in interstate commerce in the United States is at least 60 percent."

It is my understanding that the Motor Vehicles Manufacturers Association, the automotive parts industry, and labor, including the United Auto Workers, are equally supportive of this "Made in North America" content rule. Apparently, the only real opposition to this concept stems primarily from third country firms enjoying duty remission benefits.

I look forward to further discussion about these energy-automotive matters.

With best wishes.

Sincerely,

JOHN D. DINGELL,
Chairman.

Enclosures.

STAFFERS WORRY UNITED STATES-CANADA BILL MOVES TOO FAST

(By Keith M. Rockwell)

WASHINGTON.—The legislation to implement the U.S.-Canada trade accord is moving briskly through Congress, but staffers worry

that members' weariness with trade issues may result in limited examination of some details.

The causes of that condition are manifold but the primary reason seems to be that members and staffers are "burned out" following Herculean efforts on the huge omnibus trade bill.

Since the agreement with Canada cannot be changed to any large degree, members also feel frustrated working "around the edges" of the measure.

"I think we're going to regret this five years from now. I don't think this thing is getting the scrutiny it deserves. There doesn't seem to be any inclination to get into the details, probably because everybody is tired from the trade bill," one congressional satffer said.

Specifically, the aide said he was concerned that constitutional questions, such as whether a binational panel on dumping and countervailing duties can assume the role as court of last resort, are being rushed through.

The aide noted that while subsidies will be addressed by a working group, future access for the United States in areas like investment and services will not receive the same kind of priority from the two governments.

"None of the other (groups) has any teeth, so while Canada is squeezing us to make changes in our dumping and countervailing laws, there will not be that kind of pressure on them in services and investment," the staffer said.

Unlike the trade bill, which produced district battle lines and which remains an issue in the presidential campaign, congressional aides say there is little public awareness of the Canada pact.

"The members aren't particularly enthusiastic and it's not a function of the trade bill so much as a function of the total lack of interest in this thing from day one. The American people are not enthusiastic about it, it's nowhere near the priority that it is in Canada," said another aide.

Despite the lukewarm response and some serious reservations about Canada's policy of export subsidies, all the staffers interviewed said the bill would pass. But one key staffer said an agreement like that with Canada, which requires fast-track negotiating authority for the president, must pass by a large margin.

Under the fast-track authority, any agreements that are negotiated must be voted up or down by Congress, without amendments. Without such authority the United States would be hard pressed to live up to its international agreements.

"Fast-track bills should pass by very large majorities. If they fail to get two-thirds of the votes in the Senate, you'll have a lot of angry members out there trying to get rid of fast-track. Without fast-track, trade negotiations are dead," the aide said.

Several Senate staffers said there are strong feelings against the fast-track process because it excludes those members not on the Finance Committee from participating in the process.

Under the fast-track procedure, any amendments to the Canada accord negotiated between the two governments could not be modified in Congress, only approved or disapproved. Senators opposing the measure would have to vote no. Some staffers worry that a vote

against any amendment offered in later years might violate the spirit, if not the terms, of the pact itself.

The trade bill, which President Reagan probably will veto next week, would change laws concerning import relief and actions against unfair foreign practices. Perhaps most important, the president has no authority to negotiate new trade agreements until a new law is passed.

Questions From Senator Riegle

Question 11(a). Canada has implemented the Auto Pact on Most Favored Nation basis, allowing all "qualified" manufacturers to import motor vehicles and original equipment parts into Canada duty-free from any country. Under the FTA, Canada has agreed not to offer the Pact's benefits to any company other than those named in Appendix 1002.1, Part 1 of the FTA. According to the Department of Commerce, the Auto Pact is not part of the FTA, therefore not subject to the GATT waiver that the U.S. and Canada are to obtain for the FTA.

Despite the FTA provision prohibiting Canada from extending Pact or Pact-like benefits to others, Canada remains obligated, under the GATT MFN principle, to offer the benefits to all vehicle manufacturers that meet the Auto Pact's performance requirements.

Are Canada's commitment in the FTA and Canada's MFN implementation of the auto Pact in conflict?

Response. The statement contained in the question that the Auto Pact is not part of the FTA and therefore not subject to the GATT waiver that the U.S. and Canada are to obtain for the FTA is only partially correct. Article 405(4) of the FTA states that the general FTA restrictions on duty waivers do not apply to waivers granted to existing recipients of Auto Pact or Pact-like benefits. These recipients are listed in part one of Annex 1002.1. However, Article 1002(1) of the FTA, which prohibits the waiver of customs duties to new recipients, is contained in the FTA. This commitment not to expand Pact membership is applicable to additional U.S. as well as third-country automotive products manufacturers. It is problematic whether there would be any GATT challenge against Canada from a third country, and what the GATT result would be. Article XXIV of the GATT exempts from GATT the preferential elimination of duties and other restrictions of commerce between parties to a free trade area conforming with Article XXIV.

Question 11(b). Which provision is controlling? Canada's commitment to the FTA or its obligation under the GATT?

Response. Article 104(2) of the FTA provides generally that in the event of any inconsistency between the provisions of the FTA and preexisting bilateral and multilateral agreements (including the GATT) the FTA prevails to the extent of the inconsistency, except as otherwise provided in the FTA. The FTA does not provide otherwise with respect to automotive products. It is therefore clear that the FTA prevails between the Parties on this point.

Question 11(c). How can Canada agree not to grant Auto Pact benefits to those who meet the performance requirements?

Response. Canada would be required under the FTA not to grant Auto Pact benefits to additional companies.

Question 11(d). If Canada were to grant Auto Pact benefits to a company other than those listed, what would the U.S. response be under U.S. law, the Auto Pact, the FTA and international law?

Response. The United States retains its right under the FTA to undertake investigations under Section 301 of the Trade Act of 1974. Under that Act, the United States makes use of the dispute settlement provisions of any trade agreements the other country is alleged to have violated. Since granting Auto Pact status to additional companies would violate the FTA, the United States could invoke the dispute settlement procedures set forth in Chapter 18 of the FTA, unless the Parties agree to use another procedure. The results of this procedure would be contained in the U.S. Trade Representative's recommendation to the President, provided for under current law. The U.S. would not take action directly under the Auto Pact, since the obligation not to expand the Auto Pact is contained in the FTA, not in the Auto Pact itself. There are no other international fora that would be appropriate to address this issue.

U.S. House of Representatives,
Subcommittee on Energy and Power,
Washington, DC, May 20, 1988.

Hon. Clayton Yeutter,
U.S. Trade Representative,
Washington, DC.

Dear Mr. Yeutter: At a meeting on May 19, 1988, between your staff and the staff of our Committee, your staff revealed that there had been private negotiations with individual Senators concerning the treatment of the uranium industry under the U.S.-Canada Free Trade Agreement.

I was startled to learn that the Administration was considering a variety of subsidies to the uranium industry in return for the support of certain western Senators for the Free Trade Agreement. Among the possible subsidies mentioned by your staff that apparently were "on the table" were:

Federal Government contribution of $300 million to the owners of active uranium mill sites to share in their cost of reclamation;

Agreement to cease the use of the government uranium stockpiles for overfeeding in the enrichment process and promises of government purchases of additional uranium for use in overfeeding;

Endorsement of government enrichment corporation legislation that would establish the program's debt at $360 million, compared to the Administration's estimate of a $3.5 billion debt, and the General Accounting Office's estimate of $8.8 billion.

While I can certainly understand your interest in securing passage of the Free Trade Agreement, I find it shocking that your office would engage in private negotiations with certain Senators and an affected industry to buy votes with Federal taxpayer dollars.

The domestic uranium industry has been severely hurt in the past several years by a deep decline in demand, surplus inventory, and rising imports, and I am sympathetic to these problems. However, any proposal to provide relief to the industry, and particularly proposals that could cost taxpayers billions of dollars, should be considered in the normal legislative process.

I stand ready to work with the Administration on any legislative proposals in this area. However, any attempt to utilize implementing legislation for the Free Trade Agreement for purposes of carrying out private deals involving taxpayer's money will meet with the strongest opposition.

To clarify the situation, please provide me with the answer to the following questions no later than Wednesday, May 25.

(1) Please list all meetings held during the week of May 16 between Administration officials and legislators or industry representatives on the subject of uranium. Please identify all participants, the subject of discussions, and provide all documents, including notes of such meetings.

(2)(a) Does the Administration support Title I of the S. 2097, relating to uranium imports?

(b) Is Title I consistent or inconsistent with the Free Trade Agreement? Please explain.

(3) With respect to any private agreements being discussed on this matter, is it the Administration's intention to send up separate legislation, or do you intend to incorporate the deals in the free trade legislation?

(4) With respect to any proposal "on the table," please provide a cost estimate.

Sincerely,

PHILIP R. SHARP,
Chairman.

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
Washington, DC, May 6, 1988.

Hon. CLAYTON K. YEUTTER,
U.S. Trade Representative,
Washington, DC.

DEAR MR. YEUTTER: Since Subcommittee Chairman Florio and I last wrote to you concerning the U.S.-Canada Trade Agreement, the Committee has noticed an article in the May 5, 1988 edition of *Inside The White House* that negotiations have just been "finished" regarding some "side letters" related to the Agreement. The letters with Canada are "to clarify which Canadian restrictions of U.S. investment in the energy sector would be allowed to remain in place."

I request a copy of all letters, when the are final, related to the Agreement that have been negotiated, as well as an explanation of their purpose and the reasons for negotiating them. Please also identify all other negotiations now underway that are likely to result in "side" letters or agreements and indicate their status. I also understand that there are changes in the "confidential" draft

legislation (such as page 4) that have not been provided to all the Committees. I request a copy of all of the revised pages.

As you can imagine, it is difficult for the Committee to evaluate these matters in a timely fashion if we are not provided difficulties and to avoid delay. I request your reply to these matters within the next several days.

With best wishes.

Sincerely,

JOHN D. DINGELL,
Chairman.

U.S. TRADE REPRESENTATIVE,
EXECUTIVE OFFICE OF THE PRESIDENT,
Washington, DC, July 27, 1988.

Hon. JOHN D. DINGELL,
Chairman, Committee on Energy and Commerce,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: Thank you for your letter of May 6, regarding agreement with Canada in connection with the Free-Trade Agreement (FTA) with Canada and changes in the proposed draft implementing bill for the FTA.

You have already received copies of the three exchanges of letters of January 2, which were sent to you along with a copy of the final text of the FTA in early January. The only other exchange of letters pertains to "grandfathered" Canadian investment policies in the oil and gas industry and in the uranium industry. This exchange, which was provided to your staff on May 19, consists of a letter dated May 12 from Canadian Finance Minister Wilson to Secretary Baker and Secretary Baker's response of May 16. This exchange is presumably that alluded to in the press report to which your letter refers, as there are no other side agreements on investment.

This exchange was called for by paragraph four of Annex 1607.3 of the FTA. Paragraph four grandfathers Canadian published policies concerning the oil and gas and uranium-mining industries from the certain liberalization measures otherwise required of Investment Canada. However, the grandfathered Canadian policies were to be set out in an exchange of letters to be concluded prior to introduction of implementing legislation by either party. Further, paragraph four provides that the policies could be no more restrictive than those in effect on October 4, 1987.

This exchange, an additional copy of which is enclosed, fulfills the mandate of paragraph four. The policies are no more restrictive than those in effect on October 4, and in some respects, notably pertaining to uranium mining, the policies are less restrictive. I believe the policies that are grandfathered are self-explanatory, though I would be happy to arrange a further briefing for you or your staff, if you so wish. I would call to your attention that the letters provide that the policies concerned may be liberalized, but cannot be made more restrictive.

These letters do not constitute U.S. "approval" of Canadian investment restrictions in this or any other area. The FTA provisions constitute a substantial improvement over highly restrictive Canadian policies of the past, but we will continue to press for further liberalization of Canada's remaining restrictions, including the restrictive policies set out in this exchange of letters.

There are no other side arrangements, nor are there any negotiations underway at this time. Prior to entry into force, the parties will agree on rules of procedure and a code of conduct for panels under Chapter 19 of the Agreement (pertaining to review of antidumping and countervailing duty cases). Other provisions of the FTA (e.g., Articles 608, 708 and 1906–1907) call for further negotiations after entry into force of the FTA.

We have provided your staff with updated portions of the draft produced by the Executive Branch "lawyers group." My staff and that of other executive agencies have discussed substantive and drafting issues at some length with staff of your committee and various subcommittees, in addition to the large number of hearings before which Administration officials have testified and responded to questions. It should be noted that as we consult with various committees with responsibility for different portions of the implementing bill, the bill has been undergoing revision. The lawyers group draft has in effect been superseded by drafting coming out of the consultative process, with the assistance of the House and Senate legislative counsels. It is expected that differences among the Senate and House Committees will be worked out with the Administration, in a process analogous to a conference. We have consulted with your staff regardng the approach taken by other committees on issues that, according to Speaker Wright's letter, are shared among a number of committees, including your own.

I hope this letter is helpful to you. Please let me know if I can be of further assistance.

Sincerely,

CLAYTON YEUTTER.

THE SECRETARY OF THE TREASURY,
Washington, DC, May 16, 1988.

Hon. MICHAEL H. WILSON,
Minister of Finance of Canada
Ottawa, Ontario.

DEAR MR. WILSON: I have the honor to refer to your letter of May 12, 1988, which reads as follows:

> I have the honor to inform you, pursuant to paragraph 4 of Annex 1607.3 of the Free Trade Agreement between Canada and the United States of America signed on January 2, 1988, that the policies described below constitute the published policies respecting Canada's oil and gas and uranium mining industries referred to in that paragraph.
>
> 1. THE OIL AND GAS INDUSTRY
>
> Canadian published policy respecting the acquisition by foreign investors of oil and gas businesses in

Canada contains the following provisions of relevance to the Investment Canada Act. The policy provides that, in reviewing acquisitions, the Minister responsible for Investment Canada will:

(a) disallow the direct acquisition of a healthy Canadian-controlled business with assets of at least $5 million;

(b) consider allowing the direct acquisition of a healthy Canadian-controlled business with assets of at least $5 million that is in clear financial difficulty. In such cases the Minister would review the proposed foreign acquisition to evaluate its net benefit to Canada and could negotiate, as necessary, undertakings by the acquiror in relation to the review criteria;

(c) normally allow the direct acquisition of a foreign-controlled business with assets of at least $5 million, subject to an agreement with the acquiror on conditions related to Canadian ownership and investment spending; and

(d) normally allow the direct acquisition of a foreign-controlled business with assets of at least $50 million, subject to an agreement with the acquiror on conditions related to Canadian ownership and investment spending.

2. THE URANIUM INDUSTRY POLICY (ANNOUNCED ON DECEMBER 23, 1987)

Investment Canada's review threshold levels are $5 million in assets for direct acquisitions and $50 million in assets for indirect acquisitions for the uranium industry. In reviewing an acquisition in the uranium industry, the Minister responsible for Investment Canada applies the following policy:

(a) Non-resident ownership of a uranium mining property shall be limited to 49 percent at the stage of first production.

(b) Non-resident ownership levels of a uranium mining property in excess of 49 per cent shall be permitted if it can be established that the property is in fact Canadian-controlled as defined in the Investment Canada Act.

(c) Exemptions to the policy may be granted if it can be established that Canadian partners cannot be found.

(d) Properties that were "grandfathered" under the policy existing prior to December 23, 1987 continue to be grandfathered, subject to not increasing their existing non-resident ownership levels.

(e) The offer of a three-year grace period beyond first production (available to companies under the policy in force prior to December 23, 1987 before they must meet the non-resident ownership requirement)

shall continue to apply under the current policy only for agreements reached within the twelve month period commencing December 23, 1987; and properties covered under such agreements must be brought into production within seven years of signing such agreements.

It is understood that, given that these are grandfathered policies, they may be liberalized but cannot be made more restrictive.

I would be grateful if you would confirm, on behalf of your Government, that the above paragraphs express your understanding of Canada's investment policies concerning the oil and gas and uranium mining industries.

I have the honour to propose that this letter, which is authentic in English and French, and your letter of confirmation in reply, constitute an agreement between our two Governments to enter into force on the date of your letter in reply and that it be considered an integral part of the Free Trade Agreement when the latter enters into force.

I have the honor to confirm, on behalf of my Government, that your letter expresses our understanding of Canada's investment policies concerning the oil and gas and uranium mining industries.

I further have the honor to confirm that your letter of May 12, 1988 and this reply constitute an agreement between our two Governments that will enter into force on this day and that it shall be considered an integral part of the Free Trade Agreement when the latter enters into force.

Sincerely,

JAMES A. BAKER III.
MINISTER OF FINANCE,
Ottawa, Ontario, May 12, 1988.

Hon. JAMES A. BAKER III,
Secretary of the Treasury,
Washington, DC.

DEAR MR. BAKER: I have the honour to inform you pursuant to paragraph 4 of Annex 1607.3 of the Free Trade Agreement between Canada and the United States of America signed on January 2, 1988, that the policies described below constitute the published policies respecting Canada's oil and gas and uranium mining industries referred to in that paragraph.

1. THE OIL AND GAS INDUSTRY

Canadian published policy respecting the acquisition by foreign investors of oil and gas businesses in Canada contains the following provisions of relevance to the Investment Canada Act. The policy provides that, in reviewing acquisitions, the Minister responsible for Investment Canada will:

(a) disallow the direct acquisition of a healthy Canadian-controlled business with assets of at least $5 million;

(b) consider allowing the direct acquisition of a Canadian-controlled business with assets of at least $5 million that is in clear financial difficulty. In such cases the Minister would

review the proposed foreign acquisition to evaluate its net benefit to Canada and could negotiate, as necessary, undertakings by the acquiror in relation to the review criteria.

(c) normally allow the direct acquisition of a foreign-controlled business with assets of at least $5 million, subject to an agreement with the acquiror on conditions related to Canadian ownership and investment spending; and

(d) normally allow the indirect acquisition of a foreign-controlled business with assets of at least $50 million, subject to an agreement with the acquiror on conditions related to Canadian ownership and investment spending.

2. THE URANIUM INDUSTRY POLICY (ANNOUNCED ON DECEMBER 23, 1987)

Investment Canada's review threshold levels are $5 million in assets for direct acquisitions and $50 million in assets for indirect acquisitions for the uranium industry. In reviewing an acquisition in the uranium industry, the Minister responsible for Investment Canada applies the following policy:

(a) Non-resident ownership of a uranium mining property shall be limited to 49 percent at the stage of first production.

(b) Non-resident ownership levels of a uranium mining property in excess of 49 per cent shall be permited if it can be established that the property is in fact Canadian-controlled as defined in the Investment Canada Act.

(c) Exemptions to the policy may be granted if it can be established that Canadian partners cannot be found.

(d) Properties that were "grandfathered" under the policy exisiting prior to December 23, 1987 continue to be grandfathered, subject to not increasing their existing non-resident ownership levels.

(e) The offer of a three-year grace period beyond first production (available to companies under the policy in force prior to December 23, 1987 before they must meet the non-resident ownership requirement) shall continue to apply under the current policy only for agreeements reached within the twelve month period commencing December 23, 1987; and properties covered under such agreements must be brought into production within seven years of signing such agreements.

It is understood that, given that these are grandfathered policies, they may be liberalized but cannot be made more restrictive.

I would be grateful if you would confirm, on behalf of your Government, that the above paragraphs express your understanding of Canada's investment policies concerning the oil and gas and uranium mining industries.

I have the honour to propose that this letter, which is authentic in English and French, and your letter of confirmation in reply, constitue an agreement between our two Governments to enter into force on the date of your letter in reply and that it be considered an integral part of the Free Trade Agreement when the letter enters into force.

Yours sincerely,

MICHAEL H. WILSON.

U.S. House of Representatives,
Committee on Energy and Commerce,
Washington, DC, May 6, 1988.

Hon. Clayton K. Yeutter,
U.S. Trade Representative,
Washington, DC.

Dear Mr. Yeutter: Since Subcommittee Chairman Florio and I last wrote to you concerning the U.S.-Canada Trade Agreement, the Committee has noticed an article in the May 5, 1988 edition of *Inside The White House* that negotiations have just been "finished" regarding some "side letters" related to the Agreement. The letters with Canada are "to clarify which Canadian restrictions on U.S. investment in the energy sector would be allowed to remain in place."

I request a copy of all letters, when they are final, related to the Agreement that have been negotiated, as well as an explanation of their purpose and the reasons for negotiating them. Please also identify all other negotiations now underway that are likely to result in "side" letters or agreements and indicate their status. I also understand that there are changes in the "confidential" draft legislation (such as page 4) that have not been provided to all the Committees. I request a copy of all of the revised pages.

As you can imagine, it is difficult for the Committee to evaluate these matters in a timely fashion if we are not provided all of the documents. I know you do not want to avoid those difficulties and to avoid delay. I request your reply to these matters within the next several days.

With best wishes.

Sincerely,

John D. Dingell,
Chairman.

The U.S. Trade Representative,
Executive Office of the President,
Washington, DC.

Hon. John D. Dingell,
Chairman, Committee on Energy and Commerce,
House of Representatives, Washington, DC.

Dear Mr. Chairman: Thank you for your letter of April 19 transmitting additional questions regarding the U.S.-Canada Free Trade Agreement (FTA). The Administration's response are as follows:

Question 1. In your letter, you said that as of February, you lacked information about what Canadian laws and regulations "need to be amended." Have you better information now?

Response. The FTA sets out a large number of obligations for both parties, most of which are cast in general terms (such as variations on a "national treatment" obligation), others of which are more specific (*e.g.,* Article 903 prohibition on non-reciprocal export taxes on energy products), and a few that require a party to make particular amendments in existing law (*e.g.,* Article 2007 requires Canada to eliminate the "print-in-Canada" requirement in its

Income Tax Act). With respect to the latter category of changes, the Administration is of course aware of those Canadian laws and regulations that will need to be amended to bring Canada into conformity with the FTA. The list of such amendments can be gleaned from the FTA itself; for example, the measures listed in annexes to Chapters 4 and 9.

With respect to the other two categories of obligations, it is not feasible at this time to compile a precise list of amendments that might be required in order for Canada to honor its commitments under the FTA. This is due principally to the fact that Canada may legitimately choose to honor many of the obligations in the FTA in any one of a variety of ways—including by amendment or repeal of any of one or more existing statutes or regulations in a particular sphere, the adoption of new laws or regulations, the administrative reinterpretation of existing measures, executive proclamation, change in administrative procedure, policy, or practice under existing discretionary legal standards, or simply by choosing not to apply existing privisions of law. Indeed, if Canada chooses in its implementing legislation to have the FTA preempt existing Canadian law, Canada could choose to leave certain inconsistent measures in place, rendering them without legal effect as they applied to U.S. goods, services, and investments under the FTA.

The Administration intends closely to examine Canada's implementing legislation, together with changes in current Canadian procedure, policy, and practice, to ensure that they bring Canada satisfactorily into compliance with its obligations at the time the FTA enters into effect. In its scrutiny of such changes, the Administration intends to rely not only on its own knowledge of current Canadian measures at variance with the FTA, but also on the private sector, which has day-to-day experience with the operation and effect of Canadian governmental actions. We would encourage you to request interested constituents in your district to examine carefully Canadian implementing actions and to bring to our attention any federal or provincial laws or regulations which will need to be changed.

Question 2. In reply to our question 1, you indicate that it is up to Canada "to determine how provincial compliance will be achieved, just as it is our responsibility to ensure state compliance." It is my understanding that the legislation will make it clear that the Free Trade Agreement (and the application thereof) wil not be superior or prevail where there is a conflicting Federal statute (inlcuding, we presume, court interpretations thereof), but it might prevail over conflicting State law. Is that correct? Please explain.

During hearings, Administration witnesses indicated an intention, not previously mentioned, of including some specific language regarding State laws regulating or taxing insurance. Please explain in greater detail why such a specific provision is required by the Agreement and indicate how that is consistent or inconsistent with present Federal law regarding the role of States in insurance matters. Also how would this provision be enforced and how would it affect the insurance industry and consumers?

Response. The relationship between the FTA and federal law depends on the provisions of the implementing act. While a number

of approaches is possible, the Ways and Means and Finance Committees seem to be nearing a consensus on the approach stated in your letter. This version of the implementing act would specifically amend certain existing provisions of federal law, and add certain new provisions, in order to bring the United States into compliance with the FTA. But the act would also declare that the FTA does not take precedence over existing federal statutes that might be in conflict with the FTA. Under this approach, courts—and the Executive Branch—would try to determine whether a particular statute could be interpreted consistently with the FTA, but would be required to give precedence to the statute over the FTA in the event of an actual conflict.

The proposed implementing act language you refer to is necessary by virtue of section 2 of the McCarran-Ferguson Act (15 U.S.C. 1012), which states that no federal statute shall be construed to supercede any state law regulating the business of insurance unless the federal statute "specifically relates to the business of insurance." Several provisions of the FTA (for example, Chapters 14, relating to services, and 16, governing investment) do apply to state and provincial measures regulating the insurance business, although "grandfathering" provisions in the FTA limit the Agreement's application to further such measures only. Given the requirement of the McCarran-Ferguson Act, the implementing act must make specific reference to the business of insurance in order for the FTA's provisions covering the insurance business to be given effect with respect to state insurance laws.

Although the insurance business must, for statutory reasons, be specifically mentioned in the implementing act, insurance is in every other respect treated in the same way under the FTA and the implementing bill as other services covered under the Agreement. As mentioned above, neither the implementing act nor the FTA will have any immediate impact on state or federal regulation of insurance matters since existing measures regarding covered services and investments are "grandfathered" under the Agreement.

With respect to future measures, the Agreement principally requires the states and federal government to afford "national treatment" to Canadian insurance providers, both with respect to their provision of insurance services and to investments in the insurance business. "National treatment" does not necessarily require identical treatment, however. States may treat Canadian insurance providers differently than local such providers when the difference in treatment is necessary for prudential, fiduciary, health and safety, or consumer protection reasons provided that the treatment accorded to Canadian firms is equivalent in effect to that accorded local providers.

The Administration has consulted closely with the insurance industry and the states concerning the national treatment requirement and does not anticipate that it will have any adverse impact on state regulation of the insurance industry, on the industry itself, or on consumers. Indeed, we are advised that current state laws regarding out-of-state insurance providers generally afford "national treatment" to foreign insurance firms.

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Question 3. In regard to the Agreement's Annex regarding the Bonneville Power Administration's Intertie Access Policy, enclosed is a March 8, 1988 letter the Committee received from the California Energy Commission. The Committee requests your comments on the Commission's letter in consultation with BPA and the Secretary of Energy. Do you agree that the fears raised by the Commission are real and that some Congressional discussion is needed? Please explain.

Response. We do not believe there should be cause for concern regarding the effect of the Agreement on the relationship between BPA and California utilities. We have consulted with BPA and the Department of Energy on this question. The Administration position on this is as stated in the USTR letter enclosed in the California Energy Commission's letter. The Agreement deals only with the international trade aspects of the complex West Coast electricity market, and specifies that Canadian utilities should be accorded treatment no less favorable than that accorded comparably situated U.S. utilites. The Agreement takes no position regarding the BPA policy of distinguishing among different groups of U.S. utilities. We believe it should be possible to agree on report language to clarify this situation, should the Committee consider it necessary, and will be pleased to work with Committee staff and all interested parties to develop such language.

Question 4. A representative of the United Auto Workers recently testified before the Committee on Ways and Means about the Agreement. He said:

> The UAW has a significant interest in the terms of the United States-Canada "Free Trade Agreement" because Canada is the largest trading partner of the U.S., and auto trade is such a large proportion of that trade. We have concluded that the agreement does not satisfactorily address the interests of American auto workers, nor does it promote the U.S. employment and production needed to reduce the U.S. trade deficit with Canada.
>
> The provisions of the agreement related to auto trade fail to eliminate the inequities in U.S. and Canadian implementation of the Auto Pact and the growing use of imported parts is not sufficiently discouraged. Thousands of American auto workers' jobs would be at risk under the Canadian value-added requirements (safeguards) imposed on Canadian auto producers to continue, while the U.S. has no similar requirements. The continuation of these one-sided provisions under the FTA would protect the already disproportionately large Canadian assembly capacity if cutbacks in overall North American production take place.
>
> Under the FTA, the North American value required of vehicles to qualify for duty-free entry into the U.S. would be too low to prevent serious erosion in the North American content of vehicles produced by the U.S.-based companies or to significantly increase the North American value included in transplants. The auto provision of the FTA leave Canadian production incentives for Honda, Toyota

and Hyundai in place until 1996. This is nothing less than a subsidy of Canadian production, much of which will be sold in the U.S. These "duty remission" provisions give Canadian parts producers an advantage over U.S. sources in obtaining supply contracts with the transplants.

Problems with the auto provisions of the FTA would be sufficient to cause serious UAW reservations regarding the agreement. Unfortunately, there are other provisions that present similar problems. Canada's economy now has significantly more government intervention than the U.S. and the agreement tends to lock in that imbalance. The issue that fueled Canada's interest in these negotiations, the application of U.S. trade laws to Canada, was resolved with some precedents that are unsettling to American workers. The antidumping and countervailing duty laws of both countries would remain in effect for five years, while negotiations to establish a new system for treating products unfairly shipped between the U.S. and Canada proceed. American workers have nothing to gain by treating unfairly traded Canadian goods under domestic antitrust law rather than the current trade statutes. Developing a list of unacceptable subsidies would be equally unsatisfactory. The FTA contains another provision that would change the procedures for handling Section 201 cases. Achieving relief for a U.S. industry from Canadian imports could be more difficult under these circumstances.

The result of the negotiations with Canada is more "standstill" agreement than a "free trade" agreement. It permits impediments to free trade in a variety of important industries. We expect that the FTA, on its own and as a precedent for the GATT round, will provide even better opportunities for American *corporations* to serve markets abroad, but in a way that offers little benefit to American workers. The UAW strongly believes that adoption of this agreement would not serve the interest of our members or other workers throughout the nation. There is no evidence that this agreement would contribute to reducing the U.S. trade deficit with Canada or significantly expand nationwide employment opportunities for American workers.

On April 26, 1988 (the same day Prime Minister Mulroney is now scheduled to be in the U.S. and address the Congress), the President of the UAW will testify before the Subcommittee on Commerce, Consumer Protection, and Competitiveness. We request your comments on these matters.

As you have observed in your letter, the duty remission program for Honda Canada Inc., Hyundai Auto Canada Inc., Toyota Manufacturing Canada, Inc., and CAMI Automotive Inc. will continue to be operative (despite its illegality) until January 1996. The reason you give is that the "Canadian Government was not willing to renege on contractual obligations made in return for investment already in place or started." It appears therefore that the U.S. has acceded to that spurious contention, even though in an April 30, 1986 memorandum, the Trade Representative's General Counsel

said such a program would likely be considered "a production subsidy subject to the reporting on consultation procedures in GATT Article XVI, and the Subsidies Code." Later in July 22, 1986 memorandum to you, the General Counsel specifically said this program was "inconsistent with Article 9 of the Subsidies Code."

While your reply to my question 32(c) is informative and helpful, the fact remains that if Congress approves this Agreement between the U.S. and Canada it would appear to have sanctioned this illegal act on the part of Canada until 1996. That is extremely troubling particularly if the concerns expressed by the State of Michigan on March 1, 1988 to the Ways and Means Committee (as well as those expressed by the UAW) are correct.

In our view, this is a matter that needs further consideration as you work with Congress and this Committee to develop the appropriate legislation. The potential discrimination feared by many must be avoided if Canada is going to have its say regarding these contractual arrangements, particularly when the contracts themselves are apparently not available to the Congress or others. Your assurances and thoughts in this regard are essential.

Response. Automotive trade issues were some of the most difficult issues for us to address in the Canada-U.S. Free Trade Agreement negotiations. Unfortunately, the Canadian Government was just not politically in a position to re-negotiate the 1965 Auto Pact which permitted the so-called Canadian "safeguards". Had we insisted on their doing so, there would have been no Agreement and the substantial benefits of the Agreement would not be reaped. Instead we were able to bring the negotiations to a successful conclusion, although we were admittedly not able to achieve all our goals. In the automotive sector specifically, we were not able to address all measures which distort bilateral trade; however, the trade situation under the Agreement will be a significant improvement over the present situation.

Since the Auto Pact could not be renegotiated, we sought, alternatively, to fence off the Auto Pact and create an alternative channel for automotive trade under the Free Trade Agreement that would not only be eventually free of all tariff barriers, but other trade distortions as well. We believe that we have largely achieved this result in the Agreement.

The Canadian participants in the Auto Pact will be limited to its current members and pact-like benefits will be restricted to only those applicants from a prescribed list who qualify by the 1989 model year. This will freeze the application of Canadian performance requirements related to the Auto Pact and the extension of multilateral sourcing benefits to new participants.

With respect to the treatment of automotive trade under the Agreement, a number of beneficial changes in automotive trade were negotiated. For example, under the Agreement, bilateral tariffs on autos and trucks and parts for use as original equipment will be phased out over 10 years. Tariffs on aftermarket parts will be eliminated over 5 years.

Under the Free Trade Agreement and after the phase out of duties, firms will have a choice for purposes of duty-free, bilateral trade, or continuing to operate under the Auto Pact and meeting

the Canadian peformance requirements, or to trade under the Agreement and not be subject to any performance requirements.

Under the Agreement, eligibility for FTA-tariff treatment will be determined by a new, more stringent rule of origin based on 50 percent North American (U.S. and Canada) materials and direct cost of processing. This new rule will also apply to imports into the U.S. under the Auto Pact.

Under the Free Trade Agreement, certain customs provisions, Foreign Trade Zones, and duty drawback, which served to encourage the use of imported automotive parts can no longer be used to escape import duties for exports between Canada and the United States after 1994.

Canada has agreed to eliminate its duty remission programs which many have felt had been distorting bilateral trade in recent years. The programs conditioned on export performance, which were specifically cited as inconsistent with GATT obligations by my General Counsel, will be eliminated with respect to exports to the United States immediately upon implementation of the FTA and with respect to third country exports by January 1, 1998. Those programs conditioned on Canadian production performance requirements (and not previously cited by my General Counsel as inconsistent with GATT obligations) will be terminated by January 1, 1996.

By approving and implementing this Agreement, Congress will not have ". . . sanctioned this illegal act on the part of Canada until 1996"; rather the Congress will be accepting the Canadian government's agreement for immediate termination of duty remissions based on exports to the United States by January 1, 1989, and based on exports to third countries by January 1, 1998; and the elimination of the production based requirements within six years. With respect to either of these Canadian performance requirements or those maintained by Canada under the Auto Pact, we have reserved all our GATT rights as well as preserved the private course of action available under U.S. law for U.S. industries to seek relief from subsidies which are found to materially injure them.

Lastly, with respect to concerns stated in the UAW testimony with respect to the use of section 201, we do not agree that the FTA will make it more "difficult" to obtain import relief. The Agreement does nothing that would reduce the ability of the United States to use Article XIX of the GATT to provide a remedy for those industries or workers being seriously injured by a substantial increase in imports. What the Agreement does provide is that both Canada and the U.S. will exclude the other from global import relief action unless bilateral imports are substantial and are contributing importantly to the serious injury or threat of serious injury. And even if Canada were initially excluded from any potential relief action by this provision, the Agreement permits the U.S. subsequently to include Canada in a global action should a surge of imports emanate from Canada. The Agreement also provides for bilateral relief actions during the 10-year transition period phasing out tariffs. This in no way can be envisioned as reducing the relief currently available under section 201 nor making the seeking of such relief more difficult.

Besides the long-range benefits of the Agreement for the two economies, we believe that the Agreement clearly provides for freer trade in the automotive sector to the benefit of both industry and labor. We also believe that the report of the select panel, provided for by the Agreement, will point out other areas where the two governments can completely eliminate any residual trade distortions and improve the international competitiveness of the indigenous automotive industry.

Question 5. In response to my question 32(b), the Commerce Department said the "rule of origin for the FTA will be used to determine whether a vehicle is Canadian and eligible for duty-free treatment entry" into the U.S. The Department then states:

> To confer eligibility for FTA tariff treatment, the rule of origin requires sufficient processing in the United States or Canada of third-country products to result in a prescribed change in tariff classification under the harmonized system. Where numerous parts from the U.S., Canada and third-countries are assembled together, this change in tariff classification rule alone may not be adequate to ensure that substantial work is performed in the United States and Canada. Therefore, in these cases, the FTA rule is supplemented with a 50 percent North American content test that is based on the value of North American materials and direct cost of processing as a percentage of the total value of materials and direct cost of processing. This same 50 percent test applies to motor vehicles.
>
> The FTA rule of origin is a better rule than the Auto Pact rule (the current rule) because it excludes profits and costs that are not part of the manufacturing process. These exclusions make it harder for producers to manipulate the numbers (e.g., increase its profit margin) to meet the origin requirement.

In commenting on this percentage, a State of Michigan representative pointed out its deficiencies. He said:

> The new Rule of Origin, while tougher, is too low. It does not provide enough incentive for vehicle manufacturers to source the engine and transmission in the U.S. or Canada.
>
> * * * * *
>
> The engine and transmission represent approximately 30 percent of the total manufacturing costs of a vehicle. As a result: vehicle manufacturers in Canada, specifically those operating under the Auto Pact, will be able to import duty-free engines and transmissions having an origin other than United States and/or Canadian, assemble these components in vehicles in Canada, and qualify such vehicles for duty-free treatment when entering the U.S.
>
> But the problems of the Rule of Origin go beyond the manufacturer's sourcing of the engine and transmission. Not all automotive parts are subject to the 50 percent requirement. The reality is that the 50 percent Rule of Origin could be much less.

The Rule of Origin makes it possible for certain automotive parts to be determined of Canadian origin, even though all the steel, aluminum, plastic, or other materials used in the part are imported from third countries, and the amount of processing in Canada equals less than 50 percent. For those parts, Canadian origin is conferred when a change in tariff classification takes place. When exported to the United States, it would enter duty-free.

In addition, inclusion of such parts in vehicles built in Canada would allow the manufacturer to count that part as entirely of Canadian origin for purposes of determining whether the vehicle is eligible for duty-free treatment when exported to the United States. This would also be the case for subcomponents of engines and transmissions, which of themselves must also meet the 50 percent Rule of Origin.

We request your comments. Is the State right? Could the 50 percent requirement actually result in a lower North American content? Is it a floor? Please explain. What is the "magic" in that percentage? How can this be improved in the legislation?

Response. Let me first address the points raised by the State of Michigan:

(a) Can a vehicle be treated as Canadian, and eligible for duty preference, if the engine and drive train representing approximately 30 percent of the vehicle's value are from a third country?

This can happen under the FTA rule of origin, just as it can happen under the current Auto Pact rules. However, under the FTA rule of origin, at least 50 percent of the materials and direct cost of processing must be Canadian or U.S. Under the Auto Pact rule, there is no minimum requirement for U.S. or Canadian materials or processing; instead, the foreign content is limited to 50 percent of the total value of the vehicle for customs purposes (including profit and all overhead). Therefore, under the Auto Pact, if the third country content amounts to 45 percent of a vehicle's value, the Canadian content amounts to 35 percent, and the profit and overhead amount to 20 percent, the vehicle is eligible for tariff preference, even though only 35 percent of the value is attributable to Canadian materials and processing. Under the FTA rules, the Canadian content (materials and processing) for this same vehicle would have to amount to at least 50 percent.

(b) Does the rule of origin make it possible for certain automotive parts to be determined of Canadian origin, even though all the steel, aluminum, plastic, or other materials are imported from third countries and the amount of Canadian processing is less than 50 percent?

The FTA rules of origin do not require that products be made wholly of materials obtained in the United States or Canada in order to be eligible for tariff preference. It is understood that in some cases materials obtained from third countries will be used to make new products in the U.S. or Canada. However, in determining whether products made from third-country materials are eligible for tariff preference, the FTA rules of origin effectively require that the third-country materials be substantially processed and

transformed into a different commercial article. Although each of the individual rules of origin in the FTA does not require that an explicit 50 percent value-content test be met, it is believed that this effective requirement for substantial processing and substantial transformation ensures that third-country materials will not become eligible for tariff preference as a result of relatively superficial processing in the U.S. or Canada.

(c) Can vehicle parts that are not wholly of Canadian materials be counted as Canadian for the purpose of meeting the 50 percent value-content test on finished vehicles?

As noted above, articles that are not wholly of U.S. or Canadian materials may become treated as U.S. or Canadian if the third-country materials have been sufficiently processed (in the U.S. and/or Canada) to satisfy one of the individual ruless of origin. Each of these rules effectively requires substantial processing and substantial transformation, and may in addition require explicitly that a 50 percent value-content test be met. In the case of vehicle parts, if one of the rules of origin is satisfied, then the finished vehicle part is considered as Canadian (or United States, even though it may contain some third-country materials.

On the other hand, there will be situations in which a vehicle part is manufactured from third-country materials but the processing involved does not meet one of the rules of origin. In that case, none of the value of that part may be considered as U.S. or Canadian, even though processing costs were incurred in one of those countries.

(d) Could the 50 percent requirement actually result in a lower North American content?

As noted in the first part of this answer, the 50 percent requirement in the FTA rule is a minimum requirement for U.S. and/or Canadian materials and direct costs of processing. The Auto Pact rule is a maximum limit (50 percent) on third country materials; therefore, it permits auto parts to be eligible for tariff preference with less than 50 percent Canadian content. In this sense, the FTA value-content requirement is clearly stronger.

Fifty percent is not a magical number. It is used in the FTA rule of origin for assembled products of various kinds (not just automotive products) because it will assure a substantial amount of U.S. and/or Canadian automotive components were incorporated in automobiles meeting the rule r origin.

The statement that not all automotive products are subject to the 50 percent test is correct. Finished vehicles and major components like the drive train and transmission imported directly from Canada are subject to the test. It is not correct to infer that the rule of origin for products not subject to the 50 percent test is easier to meet. The change in classification test requires substantial North American processing, which may exceed the 50 percent test in many cases.

The statement that components are considered U.S. or Canadian for purposes of the 50 percent test if third-country imports are sufficiently processed to meet the FTA rule of origin is correct. Thus, if a firm in Canada buys tires made in Canada from third country rubber and puts the tires on an automobile, the full value of the tire counts as Canadian. This approach is used in the Israeli FTA,

CBI, GSP and headnote 3(a), which applies to insular possessions. For sophisticated products, it is too difficult administratively to follow multi-staged production processes for all components back to the raw materials to subtract out any foreign value.

The FTA permits changes in the rule of origin when both the U.S. and Canadian Governments agree. It is our intent to use these procedures to change the rule of origin when appropriate to correct inequities and to adjust for changes in technology and products. This procedure could be used to seek Canadian agreement to a higher North American content test. To be consistent with current practice on issues affecting origin determination, we would like proclamation authority to implement agreed changes quickly.

Sincerely,

CLAYTON YEUTTER.

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
Washington, DC, April 19, 1988.

Hon. CLAYTON YEUTTER,
U.S. Trade Representative,
Washington, DC.

DEAR AMBASSADOR YEUTTER: Thank you for your reply of February 23, 1988 to the Committee's letter of last November concerning the U.S.-Canada Free Trade Agreement. The Committee also appreciates your "assurances" that the "Executive Branch expects to consult closely with the Congress in the preparation of the bill." That is welcome. However, as far as we can tell there has been little contact directly with this Committee over the matter. Hopefully, that will improve in the weeks ahead.

While the reply was quite helpful, there are some matters that continue to concern the Committee. Some of these are with the draft Agreement itself. Some grow out of your response and others result from our hearings and other examinations of the matter. To help us further, the Committee requests your reply within 30 days after receipt of this letter to the following matters:

(1) In your letter, you said that as of February, you lacked information about what Canadian laws and regulations "need to be amended." Have you better information now?

(2) In reply to our question 1, you indicate that it is up to Canada "to determine how provincial compliance will be achieved, just as it is our responsibility to ensure state compliance." It is my understanding that the legislation will make it clear that the Free Trade Agreement (and the application thereof) will not be superior or prevail where there is a conflicting Federal statute (including, we presume, court interpretations thereof), but it might prevail over conflicting State law. Is that correct? Please explain.

During hearings, Administration witnesses indicated an intention, not previously mentioned, of including some specific language regarding State laws regulating or taxing insurance. Please explain in greater detail why such a specific provision is required by the Agreement and indicate how that is consistent or inconsistent with present Federal law regarding the role of States in insurance matters. Also how would this provision be enforced and how would it affect the insurance industry and consumers?

(3) In regards to the Agreement's Annex regarding the Bonneville Power Administration's Intertie Access Policy, enclosed is a March 8, 1988 letter the Committee received from the California Energy Commission. The Committee requests your comments on the Commission's letter in consultation with BPA and the Secretary of Energy. Do you agree that the fears raised by the Commission are real and that some Congressional discussion is needed? Please explain.

(4) A representative of the United Auto Workers recently testified before the Committee on Ways and Means about the Agreement. He said:

> The UAW has a significant interest in the terms of the United States-Canada "Free Trade Agreement" because Canada is the largest trading partner of the U.S., and auto trade is such a large proportion of that trade. We have concluded that the agreement does not satisfactorily address the interests of American auto workers, nor does it promote the U.S. employment and production needed to reduce the U.S. trade deficit with Canada.
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> The provisions of the agreement related to auto trade fail to eliminate the inequities in U.S. and Canadian implementation of the Auto Pact and the growing use of imported parts is not sufficiently discouraged. Thousands of American auto workers' jobs would be at risk under the agreement's terms. The FTA would allow the production and Canadian value-added requirements (safeguards) imposed on Canadian auto producers to continue, while the U.S. has no similar requirements. The continuation of these one-sided provisions under the FTA would protect the already disproportionately large Canadian assembly capacity if cutbacks in overall North American production take place.
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> Under the FTA, the North American value required of vehicles to qualify for duty-free entry into the U.S. would be too low to prevent serious erosion in the North American content of vehicles produced by the U.S.-based companies or to significantly increase the North American value included in transplants. The auto provisions of the FTA leave Canadian production incentives for Honda, Toyota and Hyundai in place until 1996. This is nothing less than a subsidy of Canadian production, much of which will be sold in the U.S. These "duty remission" provisions give Canadian parts producers an advantage over U.S. sources in obtaining supply contracts with the transplants.
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> Problems with the auto provisions of the FTA would be sufficient to cause serious UAW reservations regarding the agreement. Unfortunately, there are other provisions that present similar problems. Canada's economy now has significantly more government intervention than the U.S. and the agreement tends to lock in that imbalance. The issue that fueled Canada's interest in these negotiations, the application of U.S. trade laws to Canada, was resolved with some precedents that are unsettling to American

workers. The anti-dumping and countervailing duty laws of both countries would remain in effect for five years, while negotiations to establish a new system for treating products unfairly shipped between the U.S. and Canada proceed. American workers have nothing to gain by treating unfairly traded Canadian goods under domestic antitrust law rather than the current trade statutes. Developing a list of unacceptable subsidies would be equally unsatisfactorily. The FTA contains another provision that would change the procedures for handling Section 201 cases. Achieving relief for a U.S. industry from Canadian imports could be more difficult under these circumstances.

The result of the negotiations with Canada is more a "standstill" agreement than a "free trade" agreement. It permits impediments to free trade in a variety of important industries. We expect that the FTA, on its own and as a precedent for the GATT round, will provide even better opportunities for American *corporations* to serve markets abroad, but in a way that offers little benefit to American workers. The UAW strongly believes that adoption of this agreement would not serve the interests of our members or other workers throughout the nation. There is no evidence that this agreement would contribute to reducing the U.S. trade deficit with Canada or significantly expand nationwide employment opportunities for American workers.

On April 26, 1988 (the same day Prime Minister Mulroney is now scheduled to be in the U.S. and address the Congress), the President of the UAW will testify before the Subcommittee on Commerce, Consumer Protection, and Competitiveness. We request your comments on these matters.

As you have observed in your letter, the duty remission program for Honda Canada Inc., Hyundai Auto Canada Inc., Toyota Manufacturing Canada, Inc., and CAMI Automotive Inc. will continue to be operative (despite its illegality) until January 1986. The reason you give is that the "Canadian Government was not willing to renege on contractual obligations made in return for investment already in place or started." It appears therefore that the U.S. has acceded to that spurious contention, even though in an April 30, 1986 memorandum, the Trade Representative's General Counsel said such a program would likely be considered "a production subsidy subject to the reporting on consultation procedures in GATT Article XVI, and the Subsidies Code." Later in a July 22, 1986 memorandum to you, the General Counsel specifically said this program was "inconsistent with Article 9 of the Subsidies Code."

While your reply to my question 32 (c) is informative and helpful, the fact remains that if Congress approves this Agreement between the U.S. and Canada it would appear to have sanctioned this illegal act on the part of Canada until 1996. That is extremely troubling particularly if the concerns expressed by the State of Michigan on March 1, 1988 to the Ways and Means Committee (as well as those expressed by the UAW) are correct.

In our view, this is a matter that needs further consideration as you work with Congress and this Committee to develop the appropriate legislation. The potential discrimination feared by many must be avoided if Canada is going to have its way regarding these contractual arrangements, particularly when the contracts themselves are apparently not available to Congress or others. Your assurances and thoughts in this regard are essential.

(5) In response to my question 32 (b), the Commerce Department said the "rule of origin for the FTA will be used to determine whether a vehicle is Canadian and eligible for duty-free treatment entry" into the United States. The Department then states:

> To confer eligibility for FTA tariff treatment, the rule of origin requires sufficient processing in the United States or Canada or third-country products to result in a prescribed change in tariff classification under the harmonized system. Where numerous parts from the United States, Canada and third-countries are assembled together, this change in tariff classification rule alone may not be adequate to ensure that substantial work is performed in the United States and Canada. Therefore, in these cases, the FTA rule is supplemented with a 50 percent North American content test that is based on the value of North American materials and direct cost of processing as a percentage of the total value of materials and direct cost of processing. This same 50 percent test applies to motor vehicles.
>
> The FTA rule of origin is a better rule than the Auto Pact rule (the current rule) because it excludes profits and costs that are not part of the manufacturing process. These exclusions make it harder for producers to manipulate the numbers (e.g., increase its profit margin) to meet the origin requirement.

In commenting on this percentage, a State of Michigan representative pointed out its deficiencies. He said:

> The new Rule of Origin, while tougher, is too low. It does not provide enough incentive for vehicle manufacturers to source the engine and transmission in the United States or Canada.
>
> * * * * *
>
> The engine and transmission represent approximately 30 percent of the total manufacturing costs of a vehicle. As a result: vehicle manufacturers in Canada, specifically those operating under the Auto pact, will be able to import duty-free engines and transmissions having an origin other than United States and/or Canadian, assemble these components in vehicles in Canada, and qualify such vehicles for duty-free treatment when entering the United States.
>
> But the problems of the Rule of Origin go beyond the manufacturer's sourcing of the engine and transmission. Not all automotive parts are subject to the 50 percent requirement. The reality is that the 50 percent Rule of Origin could be much less.

The Rule of Origin makes it possible for certain automotive parts to be determined of Canadian origin, even though all the steel, aluminum, plastic, or other materials used in the part are imported from third countries, and the amount of processing in Canada equals less than 50 percent. For those parts, Canadian origin is conferred when a change in tariff classification takes place. When exported to the United States, it would enter duty-free.

In addition, inclusion of such parts in vehicles built in Canada would allow the manufacturer to count that part as entirely of Canadian origin for purposes of determining whether the vehicle is eligible for duty-free treatment when exported to the U.S. This would also be the case for subcomponents of engines and transmissions, which of themselves must also meet the 50 percent Rule of Origin.

We request your comments. Is the State right? Could the 50 percent requirement actually result in a lower North American content? Is it a floor? Please explain. What is the "magic" in that percentage? How can this be improved in the legislation?

We are aware of efforts to make improvements in this matter that were apparently unsuccessful. Clearly, the matter needs more examination as we consider the Agreement, including the legislation.

With best wishes.

Sincerely,

JOHN D. DINGELL,
Chairman, Committee on Energy and Commerce.

JAMES J. FLORIO,
Chairman, Subcommittee on Commerce, Consumer Protection and Competitiveness.

CALIFORNIA ENERGY COMMISSION,
Sacramento, CA, March 8, 1988.

Hon. JOHN D. DINGELL,
House of Representatives,
Rayburn House Office Building, Washington, DC.

UNITED STATES/CANADA FREE TRADE AGREEMENT

DEAR MR. DINGELL: I am writing concerning the United States/Canada Free Trade Agreement, which the House Subcommittee on Energy and Power will consider on March 9, 1988. I am particularly concerned about a provision in the Annex to the Agreement that could be read as sanctioning a discriminatory electric transmission access policy implemented by the Bonneville Power Administration (BPA). BPA's current and proposed Intertie Access Policies result in severely restricting competition amongst buyers and sellers in the Western electricity market. The current policy has virtually eliminated transmission access for Canadian sellers of electricity who had previously enjoyed fairly open access to the California market and the proposed policy would continue restrictions on potential Canadian electricity sales.

California buys a substantial amount of power from BPA. Indeed, BPA's two largest single customers, and three of its largest eight customers, are California utilities. California also purchases surplus power from other utilities in the Pacific Northwest and Canada. Northwest and Canadian energy that is delivered to California flows over a group of transmission lines known collectively as the Pacific Intertie. BPA owns 80 percent of the northern part of the Intertie; the other 20 percent is owned by two Northwest investor-owned utilities. Below the Oregon border, ownership nd contractual rights to Intertie capacity are shared by eleven California utilities (both investor- and publicly-owned), a consortium of municipal utilities, and the Western Area Power Administration.

Before 1984, these surplus energy transactions were made in a competitive market which ensured that no seller could charge unreasonable prices to California utilities. During this period, BPA generally made capacity on its portion of the Intertie available to any nonfirm energy sellers who could negotiate deals with California buyers. This resulted in a rough natural market equilibrium between Northwest sellers and California buyers. In addition, Canadian utilities had direct access to the Intertie and thus were full participants in the market.

In 1984, however, BPA, looking for ways to increase its revenues from California sales in order to avoid rate increases to its Northwest customers, adopted its Near Term Intertie Access Policy. That policy replaced the former free market situation with an anticompetitive allocation scheme whereby each Northwest seller receives access to a fixed share of Intertie capacity, thereby creating a "mini-monoply" for each seller that insulates him from any price competition. Moreover, Canadian utilities were granted no direct access except when no Pacific Northwest utility has energy to sell. This allows BPA or other Northwest utilities to purchase Canadian energy and pass it through to California at marked-up prices, adding no value to the product ultimately delivered. BPA has proposed a Long Term Intertie Access Policy, scheduled for adoption in April 1988, that would continue (and even make worse) this anticompetitive scheme.

BPA's Intertie Access Policies are inconsistent with BPA's statutory responsibilities. The applicable statutes, enacted in 1964 and 1974, provide that BPA may use its portion of the northern part of the Intertie for its own needs first, but that any surplus capacity must be made available "to all utilities" on a "fair and nondiscriminatory basis." (16 U.S.C. §§ 837e and 838d [emphasis added].) The Ninth Circuit Court of Appeals, acting on a limited record and in a divided 2–1 decision, has upheld the validity of the *Near Term* policy (*Cal. En. Res. Cons. & Devel. Comm'n* v. *BPA,* 831 F.2d 1467 (9th Cir. 1987), but the parties still have an opportunity to seek U.S. Supreme Court review. Moreover, BPA's upcoming *Long Term* policy is not even final yet, and will be subject to judicial review in the Ninth Circuit upon its adoption.

Our primary concern with the Free Trade Agreement is that ongoing judicial review of the Intertie Access Policy should not be disrupted by Congressional action that BPA could argue implies approval of the Policy, even when no such Congressional intent exists. Paragraph 2 of Annex 905.2 of the Agreement states that

BPA's Intertie Access policy shall afford to British Columbia Hydro "treatment no less favorable than the most favorable treatment afforded to utilities located outside the Pacific Northwest." Arguably, this passage could be interpreted to sanction BPA's existing policy of discrimination against U.S. utilities outside of the Pacific Northwest (*e.g.,* those in California). Indeed, BPA has argued as much to the Ninth Circuit Court of Appeals. However, since this matter is still subject to litigation, it is essential that Congress make clear that the Trade Agreement is, at worst, neutral with respect to California's contentions that BPA has no statutory authority to discriminate against utilities outside the Northwest when allocating transmission capacity.

The Office of the U.S. Trade Representative agrees with us that the Free Trade Agreement was not intended to deal in any way with the validity of BPA's decision to discriminate against some U.S. utilities. The attached letter from the Office's chief U.S. negotiator for the energy chapter of the Agreement states that:

> [T]he trade negotiators did not intend that the FTA should require a particular outcome in pending litigation with respect to the Intertie Access Policy. * * * The FTA is silent on the question of distinctions made between different U.S. utilities regarding access.

The California Energy Commission therefore respectfully urges the Congress to clarify the meaning and intent of Annex 905.2 along the lines discussed above. We have attached to this letter proposed language to that effect that we believe would be appropriate for inclusion in the Congressional report on the Agreement.

I thank you for the opportunity to comment on this important issue. I would ask that you make this letter part of the official record of your consideration of the Agreement. Please do not hesitate to contact me, or the Commission's General Counsel, William Chamberlain, if you have any questions or comments on this matter.

Sincerely,

CHARLES R. IMBRECHT,
Chairman.

PROPOSED EXPLANATORY LANGUAGE

In providing that Canadian utilities shall be treated no less favorably than United States utilities outside the Pacific Northwest region, the agreement takes no position on the legality or appropriateness of discrimination that may now exist between United States utilities within and without the Pacific Northwest region. The Congress recognizes that the proper interpretation of existing statutes directing the Bonneville Power Administration in its administration of federal transmission lines (16 U.S.C. §§ 837e and 838d) is currently being litigated in the Ninth Circuit Court of Appeals and may be addressed ultimately in the United States Supreme Court. The conferees intend that any such litigation, including the pending cases, should proceed and be decided on its own merits by the courts, free of any implication that by approving this Trade Agreement, Congress has in some way approved or disap-

proved current interpretations of law by the Bonneville Power Administration in its Intertie Access Policy.

JANUARY 29, 1988.

WILLIAM M. CHAMBERLAIN, Esq.,
General Counsel, California Energy Commission,
Sacramento, CA.

DEAR MR. CHAMBERLAIN: I apologize for not having responded sooner to your letter of December 10 regarding the question of the recently negotiated U.S.-Canada Free Trade Agreement (FTA) and its impact on the Bonneville Power Administration (BPA) Intertie Access Policy.

As chief U.S. negotiator for the energy chapter of the FTA, I can confirm that the trade negotiators did not intend that the FTA should require a particular outcome in pending litigation with respect to the Intertie Access Policy. The provisions of Annex 905.2 of the FTA regarding access by Canada to the BPA Intertie are intended to affirm the principle of national treatment in this situation, specifically, that Canadian utilities outside the Pacific Northwest should not receive less favorable treatment with respect to Intertie access than comparably situated U.S. utilities.

The FTA is silent on the question of distinctions made between different U.S. utilities regarding access. Should pending litigation result in a change in the relative access to the Intertie for U.S. utilities outside the Pacific Northwest which are in a comparable situation to Canadian utilities seeking such access, the FTA merely requires that the Canadian utilities' access not be less favorable than that of those U.S. utilities.

I hope these comments help to clarify the questions raised in your letter. If I can be of further assistance, please let me know.

Sincerely,

R.A. REINSTEIN,
Director, Energy and Natural Resources.

THE WHITE HOUSE,
Washington, DC, May 9, 1988.

Hon. JOHN D. DINGELL,
Chairman, Committee on Energy and Commerce, House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: Thank you for your March 9 letter expressing concern over the cultural exemption in the U.S.-Canada Free Trade Agreement (FTA) and seeking information regarding negotiations on film distribution.

After extensive discussion and negotiation, what finally emerged in the Agreement on culture might be described as a standoff. Canada is exempt from the Agreement for measures they think necessary to protect their cultural industries. However, if Canada uses this exemption in a way that harms the commercial interests of our industries, we are likewise exempt from the Agreement for countermeasures we might take to offset the economic harm. Under the Agreement, we can take measures of "equivalent commercial effect" if Canada takes action that would violate the FTA if it weren't for this cultural exemption.

This is not an ideal solution by any means, but we believe that the exemption for retaliatory measures puts a powerful tool in the hands of the President. Retaliation, of course, is not the objective, but rather a means to deter unwarranted action. Any Canadian Government will have to think twice before taking actions that can result in other Canadian industries paying the price via retaliatory U.S. restrictions.

As you know, discussions concerning Canadian film distribution have been taking place for a number of months between representatives of the U.S. film industry and the Canadian Government, and we believe the problem is now resolved. On May 5, 1988, Canada's Minister of Communications, Flora MacDonald, announced proposed legislation that provides guidelines for distribution of films in Canada by U.S. companies. This plan improves considerably the distribution proposal announced last year. The Canadian Parliament must approve the legislation, and we hope this matter finally will be put to rest.

With best wishes,

Sincerely,

HOWARD H. BAKER, Jr.,
Chief of Staff to the President.

THE SECRETARY OF COMMERCE,
Washington, DC, February 23, 1988.

Hon. JOHN DINGELL,
Chairman, Committee on Energy and Commerce, House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: Enclosed is the Department of Commerce's response to your Committee's questions about the proposed U.S.-Canada Free Trade Agreement. We regret that the response was delayed.

We worked closely with the U.S. Trade Representative in responding to your Committee's concerns after the conclusion of the negotiations. I hope you find this information useful.

The Department of Energy and the Office of U.S. Trade Representative will respond separately to the questions which fall under their jurisdiction.

Sincerely,

C. WILLIAM VERITY,
Secretary of Commerce.

Enclosure.

Question 31a. Please provide a table of the present U.S./Canadian tariffs affected by this Agreement and explain when the phase out will begin and the schedule for the phase out by each country.

Answer. All Canadian and American tariffs on all products will be eliminated in stages by January 1, 1998.

Automobiles and automobile parts which are eligible for duty free entry under the Auto Pact will continue to receive duty free treatment in Canada. In the United States, automobiles and automobile parts which are eligible for duty free entry under the Auto Pact will continue to receive duty free treatment only if the new rule of origin is met. The duty on specified after-market automobile

parts in both countries will be reduced in stages over a five year period (20%/year). The tariffs on all other non-Auto Pact eligible automotive goods will be reduced in stages over a ten year period (10%/year).

Please see attached tables from each country's tariff reduction schedule. An "A" in the staging category column indicates immediate elimination of duties on January 1, 1989. A "B" in the staging category column indicates a phase-out of tariffs over a five year period, beginning on January 1, 1989. A "C" in the staging category column indicates ten equal cuts of ten percent beginning on January 1, 1989. The letter "D" refers to those tariffs which will remain free.

Question 31b. Does Canada also have a system of penalties or duties and are they covered by the above agreement. For example, will Canada retain the right to impose a duty or penalty of 9.2 percent on vehicle manufacturers subject to the Auto Pact? If yes, why?

Answer. If current Canadian vehicle manufacturers receiving Pact or Pact-like benefits do not meet the performance requirements, they will be liable for imposition of the Most Favored Nation duty (currently 9.2 percent) on third-country imports. During the FTA tariff phase out period while tariffs are being progressively reduced, the maximum tariff Canada could impose on U.S.-origin imports by these manufacturers for not meeting the performance requirements will, of course, be declining to zero. For bilateral trade after the FTA is fully phased-in, Canadian importers of motor vehicles and parts from the United States which meet the FTA rule of origin will not be liable for duties on imports from the United States.

Question 32b. I understand that the U.S. currently allows a motor vehicle manufactured in Canada to enter the U.S. duty free provided that at least 50 percent of the appraised value of the vehicle is of North American (U.S. and Canadian) origin. Under the proposed free trade agreement, which Standard of Preference—50 percent North American value, or 50 percent "direct cost of manufacturing"—will govern whether any vehicles produced by manufacturers receiving production-based duty remissions enter the U.S. duty free prior to 1996? What is the impact of either?

Answer. After implementation of the U.S.-Canada Free Trade Agreement in 1989, the rule of origin for the FTA will be used to determine whether a vehicle is Canadian and eligible for duty-free treatment entry into the United States. This will apply in all cases, whether or not the producer in Canada receives production-based duty remissions.

To confer eligibility for FTA tariff treatment, the rule of origin requires sufficient processing in the United States or Canada of third-country products to result in a prescribed change in tariff classification under the harmonized system. Where numerous parts from the United States, Canada and third-countries are assembled together, this change in tariff classification rule alone may not be adequate to ensure that substantial work is performed in the United States and Canada. Therefore, in these cases, the FTA rule is supplemented with a 50 percent North American content test that is based on the value of North American materials and direct

cost of processing as a percentage of the total value of materials and direct cost of processing. This same 50 percent test applies to motor vehicles.

The FTA rule of origin is a better rule than the Auto Pact rule (the current rule) because it excludes profits and costs that are not part of the manufacturing process. These exclusions make it harder for producers to manipulate the numbers (e.g., increase its profit margin) to meet the origin requirement.

Question 32d. What impact will this program have on the location decisions of U.S. and foreign-owned parts suppliers seeking to expand or invest in North America?

Answer. The economics of the market place and the investment climate in each country will have far greater impacts on such decisions. The production-based duty remission program has been frozen and will terminate not later than January 1, 1996 or before as current contracts expire. The export-based duty remission program has been eliminated for exports to the United States after January 1, 1989. Therefore, these programs will have little or no effect on location decisions of U.S. parts suppliers seeking to expand investment in North America. They also will have little or no impact on location decisions of foreign-owned parts suppliers because the companies they are ostensibly following to supply will get no remission on Canadian exports to the United States and no remission for exports to any other country after 1998.

Question 32. I understand that under both the production and export-based duty remission programs, Canada entered into signed contracts with foreign-owned vehicle manufacturers before authorizing remissions. What would allow Canada to terminate contracts with manufacturers under the export-based duty remission program but not contracts with manufacturers under the production-based program? Does the U.S. accept this rationale as a justification for retaining the production-based program? If yes, why?

Answer. The Canadian export-based duty remission orders are renewable on an annual basis and could thus be terminated by January 1, 1989. The production-based contracts are multi-year contracts. Canadian negotiators insisted that these contractual obligations, made in return for investment already in place or started, be allowed to run their course. Whether one accepts their rationale is not the issue. Rather, the immediate termination of one program was negotiable, the other was not.

Question 33. Under the proposed agreement, will any vehicle manufacturer in Canada be subject to the Canadian requirements of the Auto Pact? Please explain.

Answer. Under the FTA, those firms currently receiving the benefits of Auto Pact status may choose to continue to do so. In such cases, these firms will continue to be required to meet the performance requirements in the Auto Pact. With enactment of the FTA and the phase out of duties, these firms will have a choice for purposes of duty-free, bilateral trade, of continuing to comply with these requirements or to trade under the FTA and not be subject to any performance requirements. No new firms will be eligible to join the Auto Pact in Canada.

Question 33b. Under the proposed agreement, could a U.S.-non-Canada joint venture in Canada operate under the terms of the

Auto Pact? How will future joint ventures in Canada establishd with U.S.-owned vehicle manufacturers be treated? Will they be subject to the requirements of the Auto Pact or subject to the provisions not applicable to Auto Pact companies?

Answer. Under the provisions of the Free Trade Agreement, Canada has agreed not to extend Auto Pact or Auto Pact-like status to any more manufacturers. Annex 1002.1 of the FTA includes a list of those companies qualifying for customs duty waivers.

Among those firms eligible for customs duty waivers and/or production duty waivers in CAMI Automotive Inc., a joint venture betwen Suzuki and General Motors. Future joint ventures will be eligible for Auto Pact status only if a company now eligible for such status is a majority owner (51 percent or more) of the joint venture. If a joint venture meets this requirements, it can trade in automotive products either within or outside the Auto Pact framework for improts into Canada. If a joint venture does not meet this requirement, it can only trade under the FTA outside the Auto Pact.

Question 33c. If Canadian performance requirements of the Auto Pact remain intact, and vehicle manufacturers in Canada continue to increase imports of third-country vehicles and parts (whether under continued multilateral implementation under the Auto Pact or not), how will this situation affect:

(i) the ability of U.S.-based parts suppliers to sell to Canadian-based vehicle manufacturers,

(ii) vehicle production in the United States and Canada, and,

(iii) vehicle exports to the United States from Canada, and to Canada from the United States.

Answer. (i) To the extent that Canadian basd vehicle manufacturers want to export their vehicles to the United States, the FTA will improve the ability of U.S. based parts suppliers to sell to Canadian-based vehicle manufacturer. The new 50 percent test in the rule of origin based on materials and direct cost of manufacturing is a more stringent test than the previous 50 percent value-added standard in the Auto Pact. For imports into the United States, the new test will apply to both Pact members and those Canadian firms trading under the FTA.

(ii) Investment which is already in place determines the current level of production. Multilateral sourcing is limited by the 60 percent Canadian value-added requirement under the Auto Pact and the new, tougher 50 percent materials and direct cost of manufacturing test in the rule of origin under the FTA. However, the performance requirements are not currently driving investment decisions. The FTA will diminish the importance of performance requirements for investment decisions.

(iii) The continuation of Auto Pact performance requirements and multilateral sourcing will not have any additional effect on exports to the United States of cars manufactured in Canada. Under the FTA, more U.S. produced vehicles should gain access into Canada thus increasing U.S. exports. Moreover, third country vehicles imported into Canada under miltilateral sourcing will not come into the United States duty free under the Auto Pact. They can be shipped through Canada into the United States, but they

would have to pay U.S. duty upon entry since they would not meet the rule of origin requirement.

Question 33d. I understand that during Congressional hearings in 1965 to consider ratification of the United States-Canada Automotive Agreement (Auto Pact), officials of the Department of Treasury stated that the "safeguards" of the Auto Pact and the letters of commitments of the motor vehicle manufacturers in the "Letters of Undertaking" were temporary. Does this remain the U.S. Government position? When did or will the safeguards and commitments expire? What do you believe are the requirements that Canadian-based vehicle manufacturers must meet in order to achieve Auto Pact status?

Answer. The Agreeent Concerning Automotive Products Between the Government of the United States of America and the Government of Canada (Auto Pact) defines what consitutes an eligible automotive manufacturer in Canada:

"Annex A.2

"(5) 'Manufacturer' of vehicles of any following class, namely automobiles, buses or specified commercial vehicles, means, in relation to any importation of goods in respect of which the description is relevant, a manufacturer that

"(i) produced vehicles of that class in Canada in each of the four consecutive three months' periods in the base year ['the period of twelve months commencing on the 1st day of August, 1963 and ending on the 31st day of July, 1964'], and

"(ii) produced vehicles of that class in Canada in the period of twelve months ending on the 31st day of July in which the importation is made,

"(A) the ratio of the net sales value of which to the net sales value of all vehicles of that class sold for consumption in Canada by the manfacturer in that period is equal to or higher than the ratio of the net sales value of all vehicles of that class produced in Canada by the manufacturer in the base year to the net sales value of all vehicles of that class sold for consumption in Canada by the manufacturer in the base year, and is not in any case lower than seventy-five to one hundred; and

"(B) the Canadian value added of which is equal to or greater than the Canadian value added of which is equal to or greater than the Canadian value added of all vehicles of that class produced in Canada by the manufacturer in the base year."

While the 1965 Agreement prevents Canada from bestowing Auto Pact status upon any additional Canadian-based vehicle manufacturers, Annex A.3 of the same Agreement states:

> The Government of Canada may designate a manufacturer not falling within the categories set out above [in Annex A.2] as being entitled to the benefit of duty free treatment in respect of the goods described in this annex.

Canada has made use of this provision by granting "Auto Pact-like" status, including various benefits, to a number of manufacturers. Through the Free Trade Agreement, Canada has agreed to

limit existing Auto Pact and Auto Pact-like benefits to those firms listed in Annex 1002.1 of the FTA.

The United States Government does not now and never has recognized nor accepted the validity of the Letters of Undertaking as a requirement for Auto Pact status. Those were private agreements between the Government of Canada and the firms concerned.

The United States Government has always regarded the Canadian "safeguards" under the Auto Pact as transitional. Several different Administrations have sought their elimination. During the FTA negotiations, negotiators again sought their elimination.

Canadian negotiators made it clear that the matter was not negotiable, and if the U.S. insisted, there would be no FTA. This was a credible threat given the political situation in the Province of Ontario where most of the automobile industry is located.

For their part, the largest motor vehicle manufacturers in Canada have adapted to the safeguards established by the Government and have integrated their operations with United States-based affiliates to meet these commitments. Given business decisions that have been made over time, together with current market conditions, the immediate elimination of these safeguards would not substantially alter the Canadian value added maintained by the major automobile makers.

Question 33e. It is claimed that the North American motor vehicle industry has excess production capacity. How would the Canadian production and value-added requirements of the Auto Pact affect a reduction in capacity?

Answer. Investment and production decisions, including plant closings, are largely driven by market forces. However, there have been some decisions regarding production in Canada which appear to have been made to assure that the performance requirements were met. This is one of the reasons why the FTA is so important. The elimination of tariffs gives firms viable options to choose to remain under Auto Pact rules with performance requirements, or to trade under FTA rules without them.

Question 33g. These matters are particularly important in the context of the Japanese voluntary agreement that will be up for reconsideration next March. In prior correspondence about utility trucks, I have observed that Japan makes great news media propaganda about its VRA limits but then does not enforce it. Further, Japan does not mention that the VRA only covers some Japanese made vehicles. For example, it does not cover exports of Janapese vehilces from Canada. Also it does not cover vehicles assembled in the United States. The VRA limit of 2.3 million Japanese vehicles is on top of the Japanese built vehicles from Canada and those assembled in the United States. The totals are over 3 million and growing. I am concerned that the Canadian-U.S. agreement may actually result in added Japanese capacity for export to the United States. Do you agree that such a result is possible? If not, why? If yes, why is the agreement helpful?

Answer. The Voluntary Export Restraint (VER) is a Japanese program. How the Japanese choose to implement it is up to the Government of Japan. The Government of Canada has a Voluntary Restraint Agreement (VRA) with Japan. It is unlikely that they would choose to use their Canadian quota for transhipment to the

United States. The Japanese can sell all their Canadian quota in Canada. In the United STates, there is a Japanese inventory waiting to be sold.

The FTA does not affect production capacity in Japan. Regarding production capacity in Canada, the FTA reduces artificial incentives for Japanese production in Canada by elimination of the duty remission programs. It s more likely that the Japanese export restraints with the United States and with Canada will add to the problem of overcapacity in North America. These agreements have, along with recent depreciation of the dollar in relation to the yen, encouraged increased Japanese investment in North America.

Question 34. What is the Standard of Preference for vehicles entering the United States that are assembled by manufacturers in Canada operating under the Auto Pact? What is the Standard of Preference for vehicles entering the United States that are assembled by vehicle manufacturers in Canada that are not subject to the requirements of the Auto Pact?

Answer. The FTA rule of origin will be the sole test for determining whether a vehicle is Canadian and qualified for duty-free entry into the United States after the implementation of the FTA, scheduled for January 1, 1989. This rule, based on change in harmonzied system tariff classification, includes a 50 percent North American content test that is calculated in terms of the value of North American materials and direct cost of processing as a percentage of the total value of materials and direct cost of processing.

Question 35. What are eligible costs in the Standard of Preference 50 percent direct cost of manufacturing? How does it relate to direct cost of processing and national materials, change of tariff classification, and substantial transformation? Are United States and Canadian costs counted toward meeting the 50 percent direct cost of manufacturing standard?

Answer. The 50 percent test in the FTA is based on the cost incurred directly in the manufacturing process. it is calculated by dividing the value of United States and Canadian materials plus direct cost of processing by the total value of materials plus the direct cost of processing.

The cost of processing means the cost incurred in the United States and Canada in the production of goods, including:

all labor costs (e.g., benefits and on-the-job training, labor provided in connection with supervision, quality control, shipping, receiving, storage, packaging and managing at the location of the processing);

cost of inspecting and testing goods;

the cost of energy, fuel, dies, molds, tooling, and the depreciation and maintenance of machinery and equipment;

development, design, and engineering costs;

rent, mortgage, interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used in the production of the goods; and

royalty, licensing, or other like payments for the right to the goods.

Costs excluded from calculating direct cost of processing include:

general expenses, such as the cost of providing executive, financial, sales advertising, marketing, accounting and legal services, and insurance;

brokerage charges relating to importation and exportation;

communications costs;

packing cost for exporting the goods;

royalty payments related to a licensing agreement to distribute or sell the goods;

rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used by personnel charged with administrative functions; or

profit on the goods.

Materials means goods, other than those included as part of the direct cost of processing, used or consumed in the production of other goods. The value of materials means the price paid by the producer of an exported good for materials, and if not included in that price:

freight, insurance, packing and all other costs of transporting any materials to the location of the producer;

duties, taxes and brokerage fees on such materials paid in the territory of either or both FTA parties;

the cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or by-product; and

the value of goods and services provided by the importer to the foreign manufacturer which would be treated as "assists" under customs law.

The 50 percent materials and direct cost of processing test in the FTA rule of origin is used to supplement the change in tariff classification test in cases where goods are assembled from more than one product, like vehicles. For the most part, the FTA rule of origin is intended to give the same results as the substantial transformation rule that is normally used by the United States to determine the country of origin of imported products. The FTA rule was developed to make origin determinations more predictable and certain than under the current U.S. system, which requires that the substantial transformation principle be applied to each shipment of goods on a case-by-case basis.

The value of both United States and Canadian materials and processing are counted in the numerator of the 50 percent test in the FTA rule of origin.

Question 36. How does 50 percent direct cost of manufacturing differ from 50 percent North American (United States and Canada) appraised value, *i.e.,* the current Standard of Preference for motor vehicles and parts entering the United States from Canada?

Answer. The current standard of preference for automobiles simply limits the value of third-country materials in an automobile (or truck) produced in Canada to 50 percent of the appraised (customs) value of that automobile. There is *no* requirement that a minimum percentage of the value of the automobile consist of United States or Canadian materials and labor. Consequently, the "North American value" may be comprised of sales promotion and advertising costs, administrative overhead, profit and the like, in-

curred in North America and included in the appraised value of the automobile. Thus, the FTA rule assures that substantial manufacturing costs are incurred in North America, while the Auto Pact rule only assures that substantial costs or profits are incurred in North America. The FTA test is the better rule and offers less opportunity for manipulation by producers.

Question 37. Under the 50 percent direct cost of manufacturing standard, could a Canadian-based motor vehicle manufacturer import an engine and drive train into Canada, assemble these items in a vehicle, and export that vehicle to the United States duty free?

Answer. Canadian and United States auto manufacturers are best able to answer this question since they know their individual costs of processing. In polling the industry, we have heard from some that, at the exchange rates of mid-1987, it would be possible for them to assemble a vehicle using a third-country engine and drive train in the United States or Canada and meet the FTA rule of origin. Whether this will be true when the FTA is implemented will depend on exchange rates with supplying countries and the costs at a plant of labor and other materials contained in a motor vehicle. However, if a producer could meet the FTA test under these circumstances, he could also meet the existing Auto Pact rule for shipments to the United States.

Question 38. What is the dollar value of motor vehicles imported into Canada duty-free from countries other than the United States by Canadian-based manufacturers qualified to import vehicles under Canada's "multilateral implementation" of the Auto Pact? What is the dollar value from Asia; from Mexico? What is the amount of U.S. value-added in those motor vehicles? How many vehicles are being imported? What is the dollar value of original equipment components imported into Canada duty free from countries other than the United States by Canadian-based vehicle manufacturers qualified to import components under Canada's "multilateral implementation" of the Auto Pact?

Answer. The requested data are not available. Trade data published by Statistics Canada do not distinguish among the duty free programs under which automotive goods enter the country, nor among different types of importers.

THE U.S. TRADE REPRESENTATIVE,
EXECUTIVE OFFICE OF THE PRESIDENT,
Washington, DC, February 23, 1988.

Hon. JOHN DINGELL,
Chairman, Committee on Energy and Commerce,
U.S. House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: Enclosed are responses prepared by my office to your Committee's questions about the proposed United States-Canada Free Trade Agreement. I apologize for not having responded much sooner.

At the time of your initial inquiry, only the elements of the Agreement were available. I believe you will find that several matters about which you raised questions regarding those elements have now been clarified with the completion of the final text of the

Agreement, which I provided to you earlier. I hope you will find helpful these responses along with those sent under separate cover by the Secretaries of Commerce and Energy.

Sincerely,

CLAYTON YEUTTER.

Question 1. As you know, the procedure for approving this trade agreement and adopting implementing legislation in the United States are generally quite specific. What are the procedures in Canada? Specifically, what provisions of the proposed agreement require Canadian governmental action? Does that nation have a procedure similar to the 1974 Act that, in its present form, precludes amendments to the submittals by the Executive Branch? If not, what is the likelihood of the Canadian Parliament adopting amendments, reservations, etc.? What is the timing for Canadian approval? What parts of the agreement depend on provincial agreement and/or adoption of regulations, etc.? What is the process for achieving provincial agreement?

Answer. In Canada the power to make or enter into a treaty or agreement belongs exclusively to the Prime Minister and cabinet. Legally, ratification of the FTA only requires their approval. Parliamentary action is not legally required, though it may be sought at the discretion of the Prime Minister and Cabinet.

The Parliament must approve the implementing legislation for the FTA where legislative change is necessary to meet Canada's obligations. Canada does not have a process comparable to our "fast track" procedure. However, a parliamentary system enforces party discipline and amendments to bills are not made without government approval. We therefore expect the implementing legislation to be passed as submitted.

We do not yet have a list of which Canadian laws and regulations need to be amended. Canadian legislation will not be the same in all respects as U.S. legislation, because different laws are being amended and the degree of executive discretion also varies.

The Canadian Senate also must approve the implementing legislation. The Senate is an appointed rather than elected body, and traditionally does not prevent legislation approved by the elected House.

The GOC has not announced a time frame for approval of the FTA and the implementing legislation. We expect, however, that for domestic political reasons the Canadians will approxmiate the pace of approval in the United States.

Article 103 of the FTA commits the Parties to ensure compliance with the provisions of the FTA by provincial, state, and local governments. It is up to Canada to determine how provincial compliance will be achieved, just as it is our responsibility to ensure state compliance. In addition, Prime Minister Mulroney has made it clear that the necessary steps will be taken to ensure that Canada is in a position to fulfill all FTA obligations as of January 1, 1989.

Question 2. The 1974 Act defines the term "implementing bill" to include a "provision approving such trade agreement" and "approving the statement of administrative action (if any) proposed to implement such trade agreement." I am concerned about the interpretation given the Executive Branch of the meaning and scope of

that "approval." It appears quite sweeping, particularly if it encompasses understandings, discussions, etc., of the negotiations not spelled out in the actual documents. What is your understanding of this approval and its long term implications?

Answer. The Canada-United States Free Trade Agreement is an executive agreement negotiated by the President pursuant to a Congressional authorization to negotiate trade agreements, contained in Section 102 of the Trade Act of 1974, as amended (19 U.S.C. 2112). Section 102 contemplates that a trade agreement authorized thereunder may require changes in previously enacted federal laws, but it in effect stipulates that an agreement requiring such changes shall enter into force only if an implementing bill approving and implementing the trade agreement is enacted into law pursuant to Sections 102 and 151.

The meaning of Congressional "approval" of the Free Trade Agreement depends in part on the language of the implementing bill, which remains to be written; the Executive Branch expects to consult closely with the Congress in the preparation of this bill, prior to its transmittal to the Congress. We would note that past implementing legislation approving trade agreements under Sections 102 and 151 has provided that as a matter of domestic law, federal statutes prevail over the trade agreements in the event of inconsistency. Under accepted principles of statutory construction, manifestations of Congressional intent such as through committee reports also may be relevant to the meaning of the approving legislation. Thus, it is premature to venture an opinion as to how Congressional approval would be interpreted.

The statement of administrative action, like the Free Trade Agreement itself, is not a part of the implementing bill. The statement must be approved by Congress, as must the Agreement, but is not enacted and therefore does not constitute statutory law. The interpretation given it of course will depend upon the language of approval in the implementing bill and the legislative history behind such approval. Based on past practice under sections 102 and 151, the statement serves to alert the Congress and the public regarding the intended administration of the trade agreement and the implementing bill, including important regulatory changes, if any, that might be contemplated as a result of the agreement and the implementing legislation. However, the statement does not itself constitute rulemaking in a legal sense, and the statement could not be used to avoid any applicable requirements of the Administrative Procedure Act or other U.S. laws. Actual new regulations would have to be issued, and could be amended, in accordance with applicable U.S. law, including the implementing bill approved by Congress.

Question 3. Please identify any existing U.S. laws, treaties, executive agreements, orders, or regulations relating to energy, the automotive industry, investment, service, financial services, culture, intellectual property, import safeguards, dispute settlements, and subsidies and dumping that will be directly or indirectly amended or affected by this Agreement and explain how and when they will be affected or amended. This includes those amendments that the Administration expects to include under the term "implementing

bill" pursuant to the 1974 Act. Your reply should include any impacts on court decisions that are relevant and may be affected.

Answer. The Department of Energy has replied with respect to the energy provisions of the Agreement (Chapter 9). In keeping with past practices under "fast track" legislative procedures, we expect to consult closely with the Congress in the development of an implementing bill that will make all necessary changes in U.S. statutes resulting from the Free Trade Agreement. The following is a preliminary and general assessment of such necessary changes in the areas you describe. With respect to the automotive provisions, we will need to amend the rule of origin to reflect the more stringent requirements of the FTA. Changes in customs laws necessary to meet our FTA obligations concerning duty drawback and the foreign trade zones will affect the automotive sector, but will be of general applicability. Current U.S. laws regarding investment, services, culture, intellectual property and dispute settlement (Chapter 18) are either already in compliance with the FTA or are grandfathered. The safeguards law will need to be amended (Sections 201–203 of the Trade Act of 1974) to reflect the bilateral provisions, the limited exception from global actions, and the surge mechanism. Certain banking laws will need to be amended to meet the obligations of the financial services chapter. The substantive laws on antidumping and countervailing duties do not require amendment, but the provisions for judicial review of final administrative decisions will need to be amended to enable implementation of U.S. obligations under Chapter 19.

A. CULTURAL INDUSTRIES

Question 4. The October 4, 1987 "Summary of the Agreement" by the U.S. Trade Representative states:

The United States recognizes the importance to Canada of maintaining its cultural identity. At the same time however, the United States wants to ensure that Canadian cultural policies do not constitute a discriminatory and unnecessary barrier to U.S. trade. Recognizing Canadian sensitivities, the United States has agreed that certain cultural areas are not subject to the specific provisions of the agreement. For its part, Canada has agreed that cultural measures it takes will not impair the benefits the United States would otherwise expect from the provisions of the agreement. In addition, Canada has agreed to alter a number of practices that discriminate against the United States including differential postal rates for U.S. periodicals and elimination of tariffs on printed material and recordings.

The document entitled "Elements of the Agreement" (which has initialled pages) states at page 7, paragraph 1 that cultural industries "defined in Annex A are exempt from the provisions of this agreement." The definition refers to an "enterprise" engaged in a broad range of possible activities listed in the Annex. What is the term "enterprise" intended to cover? Does it cover so-called "enterprises that" engage solely, partially, or primarily in some or all of such activities?

Answer. "Enterprise" is defined in Article 201 of the Agreement to mean "any juridical entity involving a financial commitment for

the purpose of commercial gain". The cultural industries exception in Article 2005 applies to enterprises when engaged in the activities listed in Article 2012. The exception could not in our view be claimed for governmental measures affecting activities not listed in Article 2012 merely on the basis that an enterprise (e.g., a conglomerate) engaging in a non-cultural activity also engaged (e.g. through another division) in activities defined as cultural.

Question 5. Please explain the relationship of the cultural exemption with other provisions of the proposed agreement, such as the provisions of the proposed agreement, such as the provisions for protecting the retransmission of copyrighted programming.

Answer (a). In the elaboration of the final text of the agreement, it was made clear, in Article 2005, that the general exemption from the obligations of the FTA for cultural industries does *not* apply to certain specified obligations of the FTA, including the protection of retransmission of copyrighted programming under Article 2006, the elimination of duties under Article 401, compensation for forced divestiture of a cultural industry under paragraph 4 of Article 1607, and elimination of the print-in-Canada requirement for qualification for an income tax deduction under Article 2007. Cultural industries are not exempt from those FTA obligations.

Question 5(b). While I can understand and appreciate Canada's sensitivities, I am concerned about our industries and their workers. How will this exemption affect U.S. cultural industries: Could it leave the U.S. industries further exposed to protectionist measures in Canada? What is the contribution of U.S. cultural industries to the U.S. worldwide balance of trade? How can the exemption be justified in light of that contribution?

Answer. The exemption for Canadian cultural industries in the FTA should have no adverse affect on U.S. cultural industries. We achieved a substantial improvement in Canada's treatment of U.S. commercial interests in the cultural area. Tariff elimination (e.g., videos, records, printed material), improved investment provisions, and copyright protection for retransmissions are all included in the FTA. In addition, if Canada should implement restrictions in the future to the detriment of U.S. cultural industries, the United States may take measures of equivalent commercial effect in accordance with the Agreement.

Total worldwide revenues of the U.S. entertainment industry is estimated at $4.2 billion in 1986. Many Canadians are extremely concerned about the large presence the United States has in Canadian cultural industries because of the limits they feel this presents for their own cultural expression and identity. While precise and reliable figures are not available, Canadians have argued that U.S. productions account for over three fourths of total theatrical and home video revenues in Canada and that the United States contributes about 80 percent of Canada's English language book imports. However, whether one accepts the validity of Canada's arguments is not relevant. Broader coverage of cultural industries in the FTA was simply non-negotiable. Canada maintained this position from the outset of the negotiations and we were unable to move their negotiators from it.

Question 6. Please explain what paragraph 2 on page 7 of the Elements of the Agreement mean.

Answer. Paragraph 2 is the corollary of paragraph 1 of the cultural exception (Article 2005 of the final text). Under paragraph 1, either party can take measures with respect to cultural industries that otherwise would violate the Agreement. Under paragraph 2, a party adversely affected by a measure of the other party under paragraph 1 can take countermeasures that otherwise would violate the Agreement. The countermeasures would not have to be taken in the cultural area.

Question 7. I note that a "Confidential Appraisal" of the agreement printed in *Inside U.S. Trade* for October 9 states that the author expects "any future cultural measure taken will be consistent" with the agreement. That is vague. If cultural industries are exempted from the requirements of the Free Trade Agreement, what is to prevent Canada from enacting a film distribution law or other measures which will have the effect of preventing U.S. companies from distributing films in Canada.

Answer. The Agreement does not prevent taking measures in cultural industries. However, paragraph 2 of the cultural exception specifically exempts retaliatory measures of equivalent commercial effect from the obligations of the agreement. The Government of Canada thus could take restrictive measures in the cultural area without violating the agreement because of paragraph 1 of Article 2005. However, the prospect of retaliation under paragraph 2 of that Article would be a deterrent to taking actions of the kind you describe. Governments are normally reluctant to take actions that, although they may benefit some interests, will result in harmful retaliation against the same or other interest groups.

Question 8. In light of the cultural exemption, will U.S. cultural industries continue to be prevented from doing business in Canada because of Canada's restrictive investment provisions?

Answer. Due to the cultural exemption, most substantive obligations of the FTA do not apply on Canadian regulation of foreign investments in cultural industries. Nevertheless, paragraph 4 of Article 1607 ameliorates a key irritant for U.S. investors in the cultural industries, namely forced divestiture at fire sale prices.

To understand this provision, recall that Canadian policy prevents foreign investors from acquiring control of a book publishing or distribution company. If a foreign investor acquires control, it is forced to divest a majority share to Canadian investors within two years. The share inevitably will be sold at fire sale prices, since only Canadian investors may bid for the majority share. U.S. industry opposes this policy in general and particularly when it is applied to indirect acquisitions in Canada. An indirect acquisition results when e.g., a company in the U.S. acquires a second company in the United States which has a subsidiary in Canada.

Paragraph 4 of Article 1607 requires the Canadian Government to offer to purchase from the U.S. investor the Canadian subsidiary that is subject to forced divestiture in connection with an indirect acquisition. Furthermore, the offer to purchase must be at fair, open market value, as determined by an independent, impartial assessment.

This paragraph therefore makes the U.S. investor whole, compensating the investor for the value of the assets which must be disposed of. In addition, by imposing substantial budgetary ex-

penses on the Canadian Government for such forced divestitures, this paragraph makes it highly unlikely that Canada will force divestiture of an indirect acquisition. Please note that paragraph 4 applies to all cultural industries, not merely to book publishing.

Question 9. Even if Canada is required under the agreement to amend its copyright law to provide a retransmission right, this provision is extremely broad and vague. Has Canada provided assurances that fair and reasonable compensation to U.S. program owners for Canadian cable retransmissions and that the new Canadian law will not discriminate against U.S. copyright owners?

Answer. Canada has agreed to revise its copyright law and will provide essentially similar protection for retransmissions currently provided by U.S. law. The legal text contains quite specific Canadian obligations. For retransmissions which are simultaneous and unaltered, Canadian broadcasters will have to pay royalties. But if the rebroadcasts are delayed or altered, the Canadian must first obtain the permission of the program owner.

B. ENERGY

Question 11. The Confidential Appraisal states:

We were not able to agree to elimination of all restrictions on investment in the energy sector in Canada, but we did reach agreement on some liberalization of those rules. We think we can live with this situation, which includes a pledge on Canada's part not to return to the much more restrictive measures which were applied to this sector in the past.

I note that one oil and gas industry official is quoted as observing that assured access to supplies in Canada "may be the priority of the government, but from the perspective of U.S. companies, there's not much in the pact." Please explain what rules were liberalized and identify the restrictions that were not eliminated. Please explain the "pledge" and indicate how binding it is. How significant is that pledge? Was assurance of supplies the U.S. priority? If so, why?

Answer. The Canadian Government on its own eliminated key investment irritants in this sector, prior to the negotiation of the FTA. For example, the expropriatory retroactive back-in and the discriminatory Petroleum Incentives Program were dropped then. The Canadian Government felt unable to liberalize the energy investment rules further in the context of the FTA.

However, while not liberalizations, most general provisions of the investment chapter will also benefit U.S. investors in Canada's oil and gas sector. These provisions add certainty and stability to the investment climate and include bans on new measures that would impose performance requirements, local equity requirements, forced divestitures, and deviations from national treatment on entry and after establishment. These general provisions also include guarantees for freedom of transfer payments; prompt, adequate and effective compensation for expropriations and nationalizations; and dispute settlement mechanisms.

We were unable to liberalize the 50 percent Canadian ownership requirement for production licenses on federal lands. Similarly, we could not eliminate the rules (1) limiting takeovers of Canadian-

controlled oil and gas companies and (2) setting Canadian participation and production criteria for approving takeovers of foreign-controlled oil and gas companies. Such takeovers will be reviewed by Investment Canada under its current thresholds rather than the new higher thresholds for industries in general.

Through the exchange of letters to be completed before the submission of implementing legislation, Canada will be bound to make its rules on takeovers of oil and gas companies no more restrictive than those in force on October 4, 1987. This pledge is significant because the policy currently in effect is much less restrictive than under previous Canadian governments. For example, Canada now usually approves foreign acquisitions of foreign-controlled oil and gas companies, whereas previous Canadian governments were unwilling to give such assurances. It should be noted that the general grandfathering provision prevents the ownership rule for production licenses on federal lands from being made more restrictive.

Assurance of supply was a U.S. priority in the negotiations. Canada reduced oil exports to the United States in the 1970's and required very high export prices for natural gas. Therefore, it was a very high priority to assure long-term nondiscriminatory access to Canadian energy.

C. PHARMACEUTICALS

Question 30. Under the heading 'Intellectual Property," the Confidential Appraisal of the Agreement includes the following "Questions and Answers":

Question. Why is there no separate chapter on intellectual property?

Answer. In general, United States and Canadian intellectual property laws are very similar. They both provide strong protection. Therefore it proved unnecessary to draft a separate chapter on this issue.

Question. What about the long-standing problems on pharmaceuticals?

Answer. The agreement contains Canadian commitments to liberalize rules on pharmaceuticals and provide compensation for satellite retransmissions.

Question. Will Canada eliminate compulsory licensing for pharmaceuticals?

Answer. Under the agreement Canada will provide 10 years of use free of compulsory licensing to U.S. pharmaceuticals, measured from the date the drug is first marketed in Canada. Since it takes five to seven years for a drug to reach the market, the effective period of protection will be about the same as the full term of the patent.

Question. What does it mean for your Uruguay Round efforts on intellectual property in not having a separate chapter in the FTA.

Answer. The FTA includes provisions whereby the United States and Canada agree to cooperate in the GATT to establish strong intellectual property protection. It was not necessary to negotiate a separate agreement, since resolution of the two major trade irritants required only Canadian action. (Privately: we were determined to get a good deal. Canada demanded significant concessions

on exemptions from U.S. trade laws—e.g., Section 337—which we were unwilling to make in order to get an agreement. And in any case, we got the most of what we were seeking on retransmission and pharmaceuticals.

Apparently, the above document was prepared before October 4, because the media reports that on that date and after the agreement had been initiated, the pharmaceutical issue was dropped on Canada's insistence.

Answer. In mid-November, the Canadian Government enacted important amendments to the Canadian patent law. These amendments included substantial liberalization of the compulsory licensing provisions applied to pharmaceuticals. Under the old regime patented drugs were subject to a compulsory license four years after marketing on payment of just a four percent royalty. Under the new Canadian law, new drugs will be free of compulsory licensing for ten years after their introduction and royalties were more than tripled to fourteen percent.

Question 32(a). Canada gives foreign-owned vehicle manufacturers utilizing a large volume of Canadian-built parts in their Canadian assembly operations a remission of duties on vehicles manufacturer's imports into Canada. Enclosed is my letter of August 19, 1986 about the legality of these programs. Under the proposed agreement, Canada would continue the programs through 1995. Why was this year chosen? What foreign-owned vehicle manufacturers will continue to receive production-based duty remissions through 1995? Why did the United States agree to this remission extension when the program is illegal, whether export based or production based? This is the equivalent of the United States sanctifying illegal acts, which I consider highly improper.

Answer (a). Under the agreement, Canada will terminate production-based duty remission programs not later than January 1, 1996, which is the date specified in existing agreements previously negotiated between the companies concerned and the Canadian Government. The Canadian Government was not willing to renege on contractual obligations made in return for investment already in place or started. However, Canada did agree not to create additional remission programs in the future or extend or enhance those which currently exist.

The following Canadian manufacturers currently qualify for production-based duty remissions:

Honda Canada Inc./Honda of Canada Mfg., Inc.
Hyundai Auto Canada Inc.
Toyota Motor Manufacturing Canada, Inc.
CAMI Automotive Inc.[1]

Question 32(c). Under the proposed free trade agreement, will foreign-owned vehicle manufacturers eligible for duty remissions in Canada that purchase *U.S.-built parts* receive a duty remission on vehicles they import into Canada through 1995? If not, what impact will this program have on the ability of U.S.-based parts suppliers to sell to vehicle manufacturers eligible for remissions under this program? If U.S.-built parts are not given the same

[1] If it fails to qualify under Auto Pact.

treatment as Canadian-built parts under this program, is this a violation of the free trade agreement, or GATT Article 3 (National Treatment)?

Answer. There are two types of performance-based duty remission programs in Canada: those that grant duty remissions to recipients based on export performance; and those granting remissions based on production in Canada. The Free Trade Agreement requires termination of remissions based on exports to the United States immediately on entry into force of the Agreement; those based on exports to any third country must be terminated by January 1, 1998. Production-based duty waivers must be terminated in accordance with the terms of the contract between Canada and the recipient, but in no case later than January 1, 1996. The FTA also freezes the list of eligible recipients of such waivers, even during the phase-out period, to those on the specified list who have qualified.

As you know, we are seeking further information in response to Governor Blanchard's request under section 305 with respect to the precise operation of the duty remission programs. It is our understanding that the production-based duty remissions are dependent on the degree of Canadian production, and therefore U.S. parts would not generally count in determining the amount of duty remission available for a qualified recipient. We believe that duties could be remitted on imports of vehicles of parts from the United States under the terms of the remission arrangements, but we do not know at this time whether U.S. parts incorporated in the making of Canadian parts would qualify as part of Canadian production for purposes of the production-based duty remissions. However, we assume any such available benefit for exporters of U.S. parts would likely be small; that is why we insisted on elimination of these programs in the FTA.

At the same time, it is important to note that the FTA requires the phasing out of duties on U.S. parts imported into Canada, over a five- or ten-year period beginning January 1, 1989. Exporters of U.S. built parts will thus face lower and lower tariff barriers in Canada, regardless of whether the importer has complied with the terms of duty remission orders, even in the limited period prior to the required elimination of the duty remission orders under the FTA. Producers in Canada contemplating long-term supplier relationships with parts suppliers may be expected to take into account that the temporary benefit of the duty remission orders will be ended, while tariffs on U.S. parts will be coming down during the transition period and will be permanently eliminated.

As noted, both the export-based and production based duty waivers must be eliminated in accordance with the terms of the FTA. We have previously stated our view that Canada's export-based duty waivers do not fall within the terms of allowable duty drawback rules, and therefore are export subsidies contrary to Article 9 of the GATT Subsidies Code. The question of consistency of production-based duty remission orders with Article III of the GATT is more problematic. GATT national treatment rules do not generally allow internal measures that favor consumption or purchase of domestic products over imported products, or measures requiring minimum domestic content. On the other hand, there is an excep-

tion to national treatment rules for subsidization of domestic production. The GATT conformity of these production-based duty orders would depend both on the factual question of the terms of the orders and such GATT legal questions as whether duty remission would be regarded as an internal law, regulation or requirement.

Question 33(f). Will the Auto Pact be treated as part of the proposed free trade agreement?

Answer. The Auto Pact is not part of the Free Trade Agreement. The Free Trade Agreement neither terminates nor enshrines the Auto Pact. The terms of the Free Trade Agreement, however, do freeze the list of manufacturers in Canada who may be granted pact or pact-like status in accordance with part one of Annex 1002.1. Further, as provided in Article 1005, the more stringent rule of origin of the FTA will apply to U.S. imports from Canada in place of the Auto Pact rule. In other respects, the parties retain all their rights under and with respect to the Auto Pact, and we also retain our GATT rights. In Article 1001, each party makes a commitment to endeavor to administer the pact in the best interest of employment and production in the United States and Canada.

Because the rule of origin is made more stringent in the FTA than it has been under the Auto Pact, the FTA will make it more difficult for automobiles assembled in Canada to qualify for duty free treatment in the United States than is presently the case under Auto Pact rules.

Question 38. Under the proposed agreement, I understand that Canada will apply a different Standard of Preference for different motor vehicles imported into Canada from the United States—vehicles imported by qualified manufacturers under the Auto Pact, and vehicles imported pursuant to the provisions of the free trade agreement. What are the GATT implications of this treatment of different vehicles produced in the United States?

Answer. None, in terms of U.S. GATT rights. Both under the Auto Pact and under the FTA, U.S. auto products receive better tariff treatment than the Canadian MFN tariff rate. By the end of the transition period (or earlier, for products so specified in the FTA's tariff schedules), all U.S. products meeting the FTA rule of origin will enter Canada duty free, regardless whether imported by a qualified manufacturer or not. During the transition period of the FTA, so long as the Auto Pact remains in force, we have a right to expect manufacturers meeting the terms of the Auto Pact to be able to import U.S. products duty free in accordance with the terms of the Auto Pact, while other imports from the United States by other importers must receive tariff treatment no less favorable than provided by the terms of the FTA.

D. INSTITUTIONAL PROVISIONS

Question 40. This provision beginning at page 30 of the Elements of the Agreement states that it is applicable to "all disputes respecting the interpretation or application of the Agreement" and that the agreement itself establishes a Canada-U.S. Trade Commission. The Commission, in addition to resolving disputes, is going to "supervise the proper implementation" of the Agreement, "oversee

the further elaboration of the Agreement" and "consider any other matter that may affect the operation of the Agreement." It provides for "bonding arbitration." Please explain the relationship of this Commission to the "Binational Panel Dispute Settlement in Antidumping and Countervailing Duty Cases." Do they overlap in responsibilities? What is meant by the phrase "oversee the further elaboration of the Agreement." Please explain in greater detail the role of this Commission and the need for it. Is this Commission intended to have an exclusive role in disputes settements? How does it affect nongovernmental entities and the role of U.S. courts? What legislation will be required to implement this Commission and the Binational Panel?

Answer. As provided in Article 1801 of the FTA, Chapter 18 (Institutional Provisions) does not apply to the settlement of disputes in antidumping and countervailing duty cases, which are governed in the FTA exclusively by the separate provisions of Chapter 19. The dispute settlement provisions of Chapter 18 and Chapter 19 do not overlap. The Canada-United States Trade Commission (the Commission) is composed of the Canadian and U.S. cabinet officials primarily responsible for international trade, or their designees, and operates by consensus (agreement). The Commission has the dispute settlement responsibilities set out in Chapter 18, but also has the more general duties set out in Article 1802 of the Agreement, including supervising the implementation of the agreement, reviewing its operation at least annually, and overseeing the further elaboration of the Agreement. While it is difficult to draw precise lines among these general functions, "oversee[ing] the further elaboration of the Agreement" would include both elaborating procedures (as, for example, the various provisions for exchange of information) and consideration or amendments to the Agreement (subject to Article 2104).

The parties agreed that it was essential to have political level supervision and ovesight of the functioning of the agreement, the settlement of disputes, and the consideration of amendments to the Agreement. The Commission serves this function, without requiring the creation of new international bureaucracy. The Commission will resolve or supervise the settlement of all disputes under the Agreement, except matters covered by Chapter 17 (Financial Services) and, as noted, Chapter 19. In that sense, and subject to those limitations, the Commission has an "exclusive" rule in dispute settlement. However, the Commission will be calling on expert panels for matters not settled by consultation, and can refer matters by agreement to binding arbitration. The rulings of panels established under Chapter 18 cannot require a party to change its legislation, but a party that does not remedy a violation of its FTA obligations will risk retaliation by the other party if another settlement (such as compensation) cannot be agreed between the parties.

The views of the Commission are not binding on U.S. courts. Article 1808 provides for joint submission to a court of the views of the Parties on issues of FTA interpretation if the parties so agree and the rules of the court so allow. We do not contemplate proposing legislation that would require courts to accept such joint submissions of views or that would make these views "binding" on our courts.

We do not believe domestic legislation will be necessary to implement the Commission, since it is made up of federal government representatives. The FTA does not require creation of a separate, independent secretariat for the Commission. We will have to make provision for per diem and travel expenses for non-governmental panelists used in dispute settlement cases. Absent experience with the operation of the Agreement, including its dispute settlement procedures, it is difficult to tell whether and to what degree any additional funding will prove necessary for functions under Chapter 18. We will, however, seek authority analogous to that provided in Section 3 of the Trade Agreements Act of 1979 for "fast track" Congressional consideration of amendments to the Agreement or dispute settlement results under Chapter 18, if these amendments or dispute settlement results require changes in U.S. statutes. Some form of non-monetary compensation authority would also be clearly desireable for cases in which the United States might be found to have acted inconsistently with the Agreement and is unable to bring its laws into conformity in timely fashion.

FEDERAL ENERGY REGULATORY COMMISSION,
Washington, DC, February 12, 1988.

Hon. JOHN D. DINGELL,
Chairman, Committee of Energy and Commerce,
House of Representatives, Washington, DC

DEAR CHAIRMAN DINGELL: Thank you for your letter of January 19, 1988, regarding the United States-Canada free trade agreement and the questions posed in your letter of November 2, 1987, addressed to Secretaries Verity and Herrington and Ambassador Yeutter. We have now had an opportunity to review the final text of the agreement. We have also had an opportunity to review the Department of Energy's responses to the questions you posed, as set forth in Secretary Herrington's letter to you of January 19, 1988, a copy of which was sent to me at the time it was submitted. Secretary Herrington indicated in that letter that the Department of Energy worked closely with the U.S. Trade Representative, the lead negotiator of the agreement, in preparing the Department's responses to your questions.

As indicated in my preliminary letter to you of December 2, 1987, I must necessarily defer to the U.S. drafters and negotiators of the agreement with respect to their explanation of the intent, purpose, scope and intended operation of the various provisions of the agreement, and the relationship of those provisions to applicable treaties, executive agreements, statutes, regulations, executive orders and other provisions of law that might be affected by the agreement.

Thus, for instance, I defer to the negotiators of the agreement with respect to their determinations, as set forth in the Department of Energy's response to Question No. 10, as to which laws and regulations, etc., are affected by the agreement such as to require modification. I also defer to their determinations that future regulatory actions of the Federal Energy Regulatory Commission will be subject to conformity with the agreement in the same manner as other regulatory actions, and that no modifications are required

in the statutes for which the Commission has primary implementing responsibility.

I would add the following. At this time it is difficult to identify in detail what impact the free trade agreement may have on future Commission regulatory actions, and what conformity with the agreement might entail. In formulating regulatory policies, the Commission must keep in mind the overall thrust and purpose of the agreement, namely, fair and nondiscriminatory treatment of the two countries' energy industries. I see no conflict between that thrust and purpose and the Commission's mandate under its enabling statutes. Indeed, that thrust and purpose are consistent with current Commission policy. For instance, in Order No. 436–A the Commission expressly declined to adopt more stringent procedures with respect to the transportation of imported gas, stating that the Commission perceived "no valid reasons for distinguishing between the transportation of imported gas and the transportation of domestic gas. * * *"

It is also our understanding that nothing in the free trade agreement inhibits the Commission's independence in the exercise of its statutorily mandated, quasi-judicial, decisional responsibilities. In particular, I note that the Department of Energy's response to question No. 12 confirms my understanding that the Commission "could elect not to take part in consultations on a particular regulatory matter pending before it if such consultations might be considered inappropriate."

The enclosed responses to the specific questions posed in your letter were prepared within the context of the general observations discussed above. In each instance, we have reviewed the Department of Energy's response as set forth in Secretary Herrington's letter of January 19, 1988, and do not disagree with the analysis set forth therein. A copy of that letter, which contains your questions as well as the responses thereto, is enclosed for reference.

If I can be of any further assistance on this or any other Commission matter, please let me know.

Sincerely,

MARTHA O. HESSE.

Enclosure.

RESPONSES TO SPECIFIC QUESTIONS

Question No. 10

Comments are set out above, in the text of the letter.

Question No. 11

Inasmuch as the investment provisions were negotiated under the leadership of Treasury Department officials, and involve matters beyond the jurisdiction of the Commission, we have nothing to add to the Department of Energy's response.

Question No. 12

We have nothing to add beyond the comments in the text of the letter. The response to Question No. 10 is also pertinent to Question No. 12.

Question No. 13

Many of the matters raised with respect to the Bonneville Power Authority fall outside the scope of the Commission's jurisdiction. Also, the last three questions within Question No. 13 refer to matters that might be raised before the Commission in future proceedings. Accordingly, with respect to those matters, it would be inappropriate to offer any comments at this time.

Question No. 14

Inasmuch as the question and response involve the intent of the negotiators of the agreement, we have nothing to add to the Department of Energy's response. We are not aware of any regulatory incentives administered by the Commission that would be pertinent to this matter.

Question No. 15

The response to Question No. 10 is applicable here as well. The Commission will, of course, have to be particularly sensitive to issues of potential discrimination. Inasmuch as the Natural Gas Act itself mandates nondiscriminatory treatment, we agree with the Department of Energy's analysis that the free trade agreement does not in any way alter, supplant or preempt the statutory mandates of that Act.

Question No. 16

We concur in the Department of Energy's response. The Commission's policy is to apply its decisions equally to all gas transported or sold in interstate commerce without regard to the country of origin of the gas.

Question No. 17

We agree with the Department of Energy that the free trade agreement will not affect the Commission's regulatory decisions in the area of rate design, particularly inasmuch as the agreement and the Natural Gas Act both mandate nondiscriminatory treatment. The matter of "postage stamp rates" has been placed at issue—by both U.S. and Canadian producers and suppliers—in several pending rate cases, and will be addressed in the course of the decisional processes for those cases.

Question No. 18

We have no comment on the matter of how the free trade agreement might affect regulatory actions taken by the states, because the functioning of state regulatory agencies is a matter that falls beyond the scope of the Commission's jurisdiction.

Question No. 19

Inasmuch as this question and response involve the intent of the negotiators in fashioning the provisions of the agreement, we have nothing to add to the department of Energy's response.

Question Nos. 20 and 21

Inasmuch as the matters of the pricing of imports and restictions on imports fall within the jurisdiction of the Secretary of Energy and the Administrator of the Economic Regulatory Administration, we defer to the Department of Energy's response.

Question No. 22

Inasmuch as the matter of Canadian investment policy and practice falls outside the scope of the Commission's jurisdiction, we have no comment on it.

Question No. 23

Inasmuch as the matter of Tucker Act liability falls outside the scope of the Commission's jurisdiction, we have no comment on it.

Question No. 24

Inasmuch as this question and response involve the intent of the negotiators, we defer to the response of the Department of Energy.

Question No. 25

In responding to this question, we wish to stress two points. First of all, the Commission has no jurisdiction over transactions between Canadian affiliates that take place in Canada, and would not take any regulatory action that would have the purpose or effect of attempting to assert its jurisdiction in an extraterritorial manner. Secondly, with respect to Canadian gas that has entered the U.S. and has come within the Commission's jurisdiction, the Commission, in regulating affiliate relationships, will apply its regulatory requirements in a nondiscriminatory fashion. Both of these principles of Commission policy are consistent with the free trade agreement.

Question No. 26

We have no comment on how the free trade agreement may affect the manner in which the states regulate electricity, because the exercise of those functions by the states falls outside the scope of the Commission's jurisdiction.

Question Nos. 27 and 28

Inasmuch as issues regarding trade in uranium fall outside the scope of the Commission's jurisdiction, we defer to the Department of Energy's response.

Question No. 29

Inasmuch as to the matter of the report of Alaskan oil falls outside the scope of the Commission's jurisdiction, we defer to the Department of Energy's response.

THE SECRETARY OF ENERGY,
Washington, DC, January 19, 1988.

Hon. JOHN D. DINGELL,
Chairman, Committee on Energy and Commerce, House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: Enclosed is the Department of Energy's response to your Committee's energy concerns about the United States-Canada Free Trade negotiations and the proposed agreement as transmitted by your November 2, 1987, letter.

We worked closely with the U.S. Trade Representative in responding to your Committee's concerns after the conclusion of the negotiations. I hope you find this information useful.

Yours truly,

JOHN S. HERRINGTON.

Enclosure.

Question 10. Please advise what laws (such as section 202 of the Federal Power Act), regulations, and interpretations of the Department of Energy, including the Federal Energy Regulatory Commission (FERC) and the Bonneville Power Administration (BPA), and the Department of the Interior will be changed, modified, or otherwise affected as a result of this agreement either directly or indirectly and explain how they will be changed, etc. How will the agreement affect future regulatory actions by FERC?

Answer. The situation with respect to U.S. energy laws and regulations that are within the scope of the Free Trade Agreement's (FTA) coverage is essentially the same as for all U.S. laws and regulations within that scope. In general, unless a current or future law or regulation is explicitly required to be modified under the terms of the FTA, it may remain in place; however, both parties' basic obligations are defined by the general principles of the FTA, and other necessary statutory or regulatory changes may be identified.

State and local laws and regulations, and federal laws and regulations which involve the exercise of discretion, are subject to conformity with the FTA. Furture regulatory actions by FERC are subject to such conformity, as are other regulatory actions.

In the energy area, two specific U.S. laws have been identified as needing to be changed upon implementation of the FTA: (1) section 161v of the Atomic Energy Act is to be modified to exempt Canada from any restrictions on uranium enrichment which might be imposed under this provision; and (2) section 7(d) of the Export Administration Act is to be modified to allow the export of up to 50,000 barrels per day of Alaskan oil to Canada, subject to certain conditions. These commitments are listed in Annex 902.5 of the FTA. No other U.S. laws are expressly required to be changed with respect to energy by the FTA, and as of this time no decision has been made to seek to change any other U.S. law in the implementing bill.

Two or three U.S. energy-related administrative actions may be required to implement the FTA. First, the Bonneville Power Administration (BPA) is to amend its Final Intertie Access Policy to eliminate any discrimination against British Columbia Hydro based on nationality; i.e., BC Hydro is to be granted treatment no

less favorable than that accorded U.S. utilities outside the Pacific Northwest region. This commitment is listed in Annex 905.2 of the FTA. Secondly, in order to allow the export of Alaskan oil to Canada as discussed above, it will be necessary to amend the Commerce Department's regulations at 15 C.F.R. 377.6; and in this connection, it also may be necessary to amend the President's findings (see 50 F.R. 25189, June 18, 1985) permitting exports of domestic crude oil to Canada under statutory provisions other than section 7(d) of the Export Administration Act.

In the future, should Canada believe that a U.S. energy law or regulation directly discriminates against Canadian energy or is otherwise inconsistent with the commitments of the FTA, it may request consultations with appropriate U.S. Government agencies, as provided in Article 905 of the FTA. Should these consultations not resolve any differences, Canada may bring the matter to dispute settlement (discussed in response to other questions).

Incidentally, it should be noted that while the energy-specific provisions of the FTA are found in Chapter 9, a number of other provisions of the FTA are also relevant to bilateral energy trade.

Question 11. The Confidential Appraisal states:

"We were not able to agree to elimination of all restrictions on investment in the energy sector in Canada, but we did reach agreement on some liberalization of those rules. We think we can live with this situation, which includes a pledge on Canada's part not to return to the much more restrictive measures which were applied to this sector in the past."

I note that one oil and gas industry official is quoted as observing that assured access to supplies in Canada "may be the priority of the government, but from the perspective of U.S. companies, there's not much in the pact." Please explain what rules were liberalized and identify the restrictions that were not eliminated. Please explain the "pledge" and indicate how binding it is. How significant is that pledge? Was assurance of supplies the U.S. priority? If so, why?

Answer. The investment portion of the agreement was negotiated under the leadership of Treasury Department officials. Secretary Baker was not a recipient of your original letter. We have referred this question to appropriate officials at Treasury.

Question 12. The Elements of the Agreement state:

"Both sides have agreed to prohibit restrictions on imports or exports, including quantitative restrictions, taxes, minimum import or export price requirements or any other equivalent measure, subject to very limited exceptions: (1) short supply or prevention of exhaustion of a finite energy resource, but only if the exporting Party provides proportional access to the diminished supply and does not otherwise discriminate on price; or (2) national security, to supply military establishment or critical defense contracts, respond to a situation of armed conflict, prevent nuclear proliferation or respond to direct threats to supply of nuclear materials for defense purposes.

"Parties will consult on energy regulatory actions which could directly result in discrimination inconsistent with the principles of the Agreement."

(a) What current "restrictions" of the United States and Canada will be eliminated as a result of this prohibition and when?

(b) Please explain the process for the consultations on "regulatory actions," such as actions by FERC.

Answer. (a) With respect to existing restrictions, under the FTA, Canada will: (1) exempt the United States from its current policy of requiring that uranium exports be upgraded to the maximum extent possible in Canada prior to export, and (2) eliminate its requirement that electricity exports not be priced significantly less than the least-cost alternative available to U.S. importers. These commitments are listed in Annexes 902.5 and 905.2 of the FTA. Specific U.S. restrictions on energy trade to be modified are described in the answer to Question 10 and in these same Annexes. The two countries have also agreed not to impose certain future restrictions of the type one country or the other has imposed in the past, e.g., oil import quotas and fees in the United States and export restrictions, taxes and minimum prices in Canada. Articles 902, 903, 904 and 907 of the FTA contain these commitments.

(b) Under the provision for consultation on energy regulatory actions (Article 905), if either Party believes that energy regulatory actions by the other Party would directly result in discrimination against its energy goods or its persons (buyers, sellers, etc.) inconsistent with the principles of the FTA, it may initiate direct consultation with the other Party. For purposes of this provision, an "energy regulatory action" includes any action by Canada's National Energy Board (NEB) or by the U.S. Federal Energy Regulatory Commission (FERC) or Economic Regulatory Administration (ERA). The Agreement specifies that consultants on issues raised with respect to actions of the NEB, FERC and the ERA would include Canada's Department of Energy Mines and Resources and the U.S. Department of Energy. Whether other departments or regulatory agencies participated would depend on the circumstances of the specific "regulatory action"; for example, an agency could elect not to take part in consultations on a particular regulatory matter pending before it if such consultants might be considered inappropriate.

Question 13. The Elements state:

"Both sides have agreed to (1) support continuing Bonneville Power-B.C. Hydro negotiations, encouraging parties to work out their differences consistent with the objectives and principles of the Agreement; and (2) allow existing or future incentives for oil and gas exploration, development and related activities in order to maintain the reserve base for these energy resources"

I am uncertain about the purpose and effect of this statement. it appears hortatory, except for the phrase "consistent with the objectives and principles of the Agreement" and the lack of any reference to U.S. laws applicable to the BPA. Why was this provision included? How could this Agreement affect these "negotiations"? What are the "objectives and principles" that apply? Will B.C. Hydro receive access to BPA "equivalent to a non-BPA utility in Eastern Montana"? What is that utility? What are their terms of access? Is access on a "space available basis"? Is access on a firm or interruptible basis? Is access based on cost of service rates? Will any U.S. utilities receive access on a less favorable basis? Who will

enforce such an agreement (FERC, BPA, Courts, dispute resolution, etc.)? What is the practical effect of this agreement? Will California gain access to the B.C. Hydropower it has been seeking? If access results in a lower return for BPA, who will the shortfall be made up? Will rates to BPA customers be increased over the short or long term? Will the Federal government get less?

Answer. The statement quoted in the question is indeed hortatory. The objectives and principles which will apply are those contained in the FTA.

With respect to BPA, the Agreement explicitly addresses only the aspects of the Final Intertie Access Policy which may be inconsistent with the principle of National Treatment, as noted in the answer to Question 10. No other BPA administrative action is required to be undertaken by the FTA. it is assumed that future BPA actions will be consistent with the objectives and principles of the FTA. The negotiators did not reach specific agreements regarding the details of the BPA situation but felt these details were best left to be negotiated between the parties directly involved, i.e., BPA and BC Hydro. It was the clear sense of the trade negotiators on both sides that mutually beneficial results could be achieved by direct negotiations between the involved parties, and those parties are encouraged by the FTA to attempt to reach such results. The objectives of the FTA provide broad guidance for such voluntary negotiations.

The FTA was not intended by the trade negotiators to require a particular outcome in pending litigation with respect to the BPA Intertie Access Policy. If such litigation culminated in BPA's being ordered to afford B.C. Hydro more favorable access to the Intertie than is required under the FTA, the FTA would not preclude allowing it.

With regard to your more specific questions about certain utilities and markets, many of them should be answered by the new draft Final Intertie Access Policy recently rleeased by BPA. A copy is attached for your information, and BPA would be pleased ot brief you or your staff on the details.

Question 14. In regard to clause (2) above, please identify all such existing "incentives" in Canada and the U.S. Please give criteria for, and examples of, possible future incentives. Does this provision apply to disincentives as well? U.S. oil producers are currently subject to a windfall profits tax. Are the Canadians subject to such a tax? Are incentives limited to tax incentives or do they apply to regulatory "incentives?" If regulatory incentives are allowed, please give examples.

Answer. The phrase in the Elements of the Agreement referring to investment incentives in the oil and gas area, which is reflected in Article 906 of the FTA, simply recognizes that some incentives in this area are important to both countries in maintaining total North American supplies of these energy resources. There are a number of programs on both sides, at both Federal and state/provincial levels, that assist oil and gas exploration, and the negotiators did not attempt to prepare an exhaustive list of such programs. Rather, the agreement was simply that these programs did not have to be eliminated as part of the implementation of the FTA. To the degree that government subsidies on either side may

in the future result in exports that injure the other country's domestic industry, that industry will still be free to seek relief under existing countervailing duty laws, as indicated by Article 1902 of the FTA.

Question 15. (a) While tariff barriers are rather easy to identify, nontariff barriers are more complex. For example, Administration staff have explained that Order 256 by the FERC has been excluded from the agreement. However Order 256 is an example of how one Nation (the United States) may believe it is applying even-handed regulation and the other Nation (Canada) does not. The question is sure to be raised again in the context of Economic Regulatory Administration action for Canadian gas going west (California) and east (Minnesota). How do you expect the agreement to affect such cases? Is the agreement intended to preempt or supplement decisions made under the Natural Gas Act?

(b) Some in the Administration have indicated the agreement will have little effect on such cases because the agreement will not be specifically set forth in legislation. However, it is "approved" by the legislation. Also, some Administration staff indicate that they will treat policy statements in the agreement as if they were law. What is the intended effect?

Answer. The general applicability of the FTA to energy regulatory actions is explained in the answers to Questions 10 and 12. The negotiators did not attempt to analyze the precise effects of the FTA principles on every existing or proposed energy regulation. It is expected that these regulations will not discriminate directly against the energy goods or persons of the other country, and that all state or discretionary federal regulatory actions that are within the scope of the FTA will be conducted in accordance with the FTA's principles. To the extent that the other country believes there is discrimination, the FTA provides for consultation (in Articles 905 and 1804) and dispute settlement (in Chapter 18). Where U.S. laws and regulations are uniform, consistent and equitable to all parties, domestic and foreign, there should be no inconsistency with the FTA. Only those few U.S. laws and regulations noted in the answer to Question 10 have been identified as needing to be modified in implementing the Agreement.

Question 16. One of the fundamental disputes occurring in natural gas regulation is over the so-called take-or-pay problem. FERC has issued Order 500 which allows pipeline companies to condition the transportation of natural gas on receiving take-or-pay relief. Would the Free Trade Agreement anticipate extending the application of such Orders to the Canadians or to Canadian-United States agreements such as the rates guaranteed the Alaskan Natural Gas Transportation System? Although the application of Order 500 to Canadian production would be a restriction on imports, it is a restriction would be a restriction on imports, it is a restriction U.S. production also faces. Does the FTA prohibition of restrictions mean the absolute limit of restrictions or the equal application of restrictions to Canadian as well as U.S. natural gas?

Answer. The FTA does not specifically address any FERC orders or opinions. These could be affected in the manner described in the answers to Questions 10, 12 and 15. In general, FERC decisions apply equally to all gas sold in U.S. interstate commerce, regard-

less of whether it is produced in the United States, Canada or any other country (such as Algeria). The FTA prohibits discrimination against Canadian gas where such discrimination is associated with the fact of Canadian origin of the gas. Where restrictions apply equally to both domestic and imported gas, they would not necessarily be inconsistent with the FTA. In the specific case of the ANGTS agreement, because of the nature of the Treaty between the United States and Canada the FERC has exempted the Alaska Natural Gas Transportation System from compliance with several of its decisions. This stance is not inconsistent with the FTA.

Question 17. One of the anticipated disputes in natural gas regulation is rate design. An example of the potential conflict is in the area of so-called "postage stamp rates." Under this theory, transportation rates are the same whether gas is transported one mile or one thousand miles. The Canadians have argued that in the case of pipeline companies which serve areas close to Canada, the rates are discriminatory because the Canadians have to pay the same rates as U.S. producers much further away. Would the FTA affect the way FERC considers such cases?

Answer. The FTA will not impact regulatory decisions except in the manner explained in Questions 10, 12, 15. The FERC's upcoming Rate Design agenda is expected to address "postage stamp rates" which have been protested by both United States and Canadian producers in various cases.

Question 18. In the area of state regulation, United States and Canadian producers also have come into conflict. For example, California has a least cost purchasing requirement of its natural gas distribution companies. When the ordering was based on variable costs, many U.S. producers were upset that the significant fixed costs paid to the Canadians were ignored. If the ordering is changed to take these fixed cost into account, the Canadians complain. How would the FTA affect state regulation in cases like this?

Answer. State and provincial regulations governing energy trade would be subject to conformity with the FTA. If those regulations treat domestic and imported gas equally, they are unlikely to contravene the FTA. If state regulations were in fact to discriminate against Canadian energy, Canadian producers could appeal to the Canadian Government and Canada could invoke the FTA provisions on consultation and dispute settlement.

Question 19. It has been alleged in both natural gas and electricity trade that Canada has offered contracts at a discount to domestic alternative fuels. For example, Canadian gas or electricity would be offered at 80 percent of domestic gas or electricity, respectively, delivered at the city-gate. Is this practice affected by the agreement in any way?

Answer. The FTA does not regulate the terms of commercial agreements that may be freely negotiated between willing buyers and willing sellers. Rather, it limits the manner in which governments on either side may intervene to restrict trade or discriminate with respect to the terms of such agreements. Where Canadian energy is competitive and is not dumped or its exportation subsidized, there are expected to be essentially no restrictions on its importation into the United States. In fact, some have argued that the selling of electricity at 80 percent of the price of alternative

fuels represents "price gouging" relative to the actual cost of the energy. To the degree that this may have been true, the elimination of the "least-cost alternative test" under the FTA should assure U.S. consumers the most competitive price to be freely negotiated for energy supplies from any secure source.

Question 20. One of the lower price barriers of Canadian gas to the United States is the city-gate price of gas to cities in Eastern Canada. Would that floor price be affected by the FTA? What is that floor price now? How does it apply to fixed costs and how does it apply to variable costs? Would rates sold to U.S. markets below these rates and terms be considered dumping? Please answer the same question for electricity.

Answer. Decontrol of gas pricing in Canada on November 1, 1986, eliminated the so-called "Toronto city gate" floor price. Moreover, minimum export price requirements will be explicitly prohibited under the provisions of the FTA. The United States has not insisted that Canada eliminate its export price monitoring function, but the United States could object under the FTA if this were used for any purpose other than simply to assure that Canadian gas is not "dumped" in U.S. markets, which would be in violation of U.S. unfair trade laws. Rate structures for the allocation of fixed and variable costs are set by the National Energy Board in Canada, but all rates on U.S. interstate pipelines involving resale of Canadian gas are subject to FERC review. The same considerations would apply equally to electricity.

Question 21. One of the major benefits for the United States of the FTA reportedly is the limitation on the Canadians unilaterally raising prices or limiting supplies to the United States. Please list the examples of such practices that occurred over the last ten years. If the price of oil rose, what are the anticipated changes in Provincial and Canadian law which would limit such problems in natural gas? If the Canadians were to violate the FTA by raising prices or limiting supplies what would possible remedies be? I point out that the United States has very little energy exports to Canada.

Answer. Under Articles 902, 903 and 904 of the FTA, no restrictions (including minimum export price requirements) could be placed on exports except under the specific conditions where there may be exceptions. In the energy area, these generally are where there is a militarily-related national security requirement (Article 907) or where there is a situation of short supply, domestic price control program, or threat of exhaustion of a finite natural resource (Article 904). In the latter situations, as specified in Article 904, the FTA requires that the restriction: (1) not reduce the proportion of available supply that was exported during the most recent representative period (36 months unless agreed otherwise); (2) not require the disruption of normal patterns of supply or product composition; and (3) not impose a higher price on exports than is charged for comparable domestic sales. Any violation of these commitments would be addressed under the dispute-settlement mechanism described in Chapter 18. These provisions of the FTA should assure U.S. purchasers of Canadian energy equitable treatment and result in significant enhancement of our energy supply security.

There have been numerous examples of both countries' intervention in energy trade over the past 25 years, including U.S. oil import fees and quotas, Canadian oil export taxes and restrictions, Canadian minimum gas export price requirements, U.S. restrictions on enrichment of Canadian uranium, and Canadian restrictions on exports of unprocessed uranium, to name a few. It was agreed by the trade negotiators that such interventions have, in general, not been beneficial to either country over the longer term, since their net effect has been to reduce total energy supplies available to the two countries from combined resources and to increase consumer uncertainty regarding both future supplies and future prices of energy in the United States-Canada market area.

By way of background, the bilateral energy trade between the United States and Canada is quite important and, while most of it is from Canada to the United States, our exports to Canada in 1986 were not insignificant. Canada was our largest foreign purchaser of coal and other solid fuels in 1986, about $800 million in exports, and purchased overall about $1.3 billion of U.S. energy, including electricity.

Of course, in case it became necessary for the United States to suspend trade benefits to Canada following a favorable dispute resolution under Chapter 18 of the FTA, those benefits would not necessarily have to be in the area of energy trade.

Question 22. Not long ago Canada launched an effort to "encourage" energy companies which operated in Canada to have a substantial Canadian ownership. Please list all such provincial and federal requirements. Are these to be eliminated through the agreement?

Answer. See answer to Question 11.

Question 23. If private financial losses arise out of a dependence of the terms of the FTA, would the Federal government assume a Tucker Act liability?

Answer. Not to best of our understanding. Perhaps the Committee could elaborate on the specific concern regarding this statute.

Question 24. Does the specific provision for allowance of "incentives" for Canadian energy production eliminate the access of domestic producers to remedies under trade and energy laws?

Answer. No. See answer to Question 14.

Question 25. FERC is closely monitoring transactions between pipelines and their producing and marketing affiliates. How would the FTA affect the FERC review of Canadian affiliate transactions?

Answer. See answer to Question 15.

Question 26. In the United States, many of the transactions dealing with electricity are regulated by the states. How would the FTA affect this regulation? If states have a policy of not allowing the transmission of Canadian power, would the FTA override this policy?

Answer. See answer to Question 18.

Question 27. The FTA apparently anticipates the elimination of the restrictions of 161(v) of the Atomic Energy Act with respect to Canada. There has been a court decision in this area, that if upheld by the Supreme Court would likely require the DOE to impose import restrictions on uranium. If the case is affirmed, how would you envision implementing this provision?

Answer. To implement the FTA, Congress must enact legislation that would grant Canada an exemption from any import restrictions imposed pursuant to Section 161v.

Question 27(b). Would transshipments of foreign uranium through Canada to the United States be limited?

Answer. Yes. Foreign uranium shipped through Canada would be subject to import restrictions pursuant to section 161v of the Atomic Energy Act. Since third country uranium would not satisfy the FTA's rules of origin for Canadian goods (See Article 301), the Agreement would not prevent the United States from restricting its importation; moreover, Article 902.3(a) expressly recognizes that each Party to the FTA reserves the right to regulate the importation of third country energy goods transshipped through the territory of the other Party.

Question 27(c). Would Canadian uranium be afforded the same considerations as domestic uranium under 161(v)?

Answer. While the Candian uranium industry is not considered "domestic" with respect to section 161v provisions, the FTA provides the framework for Canada's being granted an exemption from any import restrictions imposed pursuant to section 161v. As indicated above, ratification of the FTA would require the enactment of implementing legislation to amend section 161v so that it is in agreement with the provisions of the FTA.

Question 27(d). Is Canadian uranium subsidized through interest free loans, grants, or government guarantees or other means? What is the extent of this subsidy?

Answer. We understand that there have been some grants and other benefits to the Canadian uranium industry in the past. The present effects of these past programs are not significant relative to the cost difference between Canadian and United States uranium production (based on ore quality). We are unaware of any present grants or other benefits being given to the Canadian industry.

Question 27(e). Will the FTA limit trade remedies allowed domestic uranium producers?

Answer. Imports of Canadian uranium would still be subject to action under U.S. trade laws (see also answer to question 14).

Question 27(f). If allowed unrestricted access, what is the anticipated impact on domestic uranium production?

Answer. No significant change in domestic uranium production is expected as a result of implementing the proposed FTA. However, one advantage of the FTA is that it would provide sales opportunities to U.S. firms that process uranium by eliminating the Canadian Government's policy that all Canadian-origin uranium be processed (converted to uranium hexafluoride) in Canada before shipment to the United States for enrichment. Under the FTA, customers would be able to have Canadian uranium processed at United States conversion facilities prior to enrichment by DOE.

Question 27(g). Does dependence on imported sources for uranium cause any national security concerns?

Answer. In 1986, foreign uranium comprised about 44 percent of domestic utility requirements, about 80 percent of which was from Canada. Since a significant majority of foreign-origin uranium is imported from Canada and we consider Canada to be a strong ally

and integral part of our national security, we believe that the continued importation of Canadian-origin uranium does not represent a national security concern.

Question 27(h). Would the Canadians be allowed to attach limitations on the use of their uranium by the United States?

Answer. Both countries would be allowed to restrict the trade in energy goods for the narrow national security purposes specified under Article 907 of the proposed agreement. Two of the purposes set out under Article 907, which may be potentially relevant, pertain to measures restricting imports or exports of energy goods to:

(c) implement national policies or international agreements relating to the non-proliferation of nuclear weapons or other nuclear devices; or

(d) respond to direct threats of disruption in the supply of nuclear materials for defense purposes.

Question 28. It has been alleged that the Canadians (1) deeply differentially price uranium ($85 per pound for Canada, $17 per pound for the United States); (2) reviews all terms and conditions for exports to the United States; (3) through contracts and other means, prevent U.S. uranium sales in Canada and (4) limit U.S. ownership of uranium in Canada. Are these allegations true? How will these practices be affected by the FTA?

Answer. These allegations are not entirely true. See answer to Question 27 and attached letter for general response. As to the particular allegations:

(1) A wide range of uranium prices prevails in both the United States and Canada due to significant changes in market conditions over the past 20 years and to differences in sources of supply and terms of sale. During the 1970s, when longer-term shortages were anticipated by many analysts, a number of utilities entered into long-term supply contracts at relatively high prices. Some of these contracts are still in force in both the United States and Canada. At the same time, recent contract and spot sales reflect a significant oversupply situation that has prevailed since the early 1980s. Some sales in recent years also reflect the newer, low-cost Canadian supplies brought on stream in Saskatchewan. Price differentials in the market in general result mostly from these different conditions. We have no evidence that the Canadian Government is currently mandating lower prices to the U.S. market, which would be contrary to their general policy of requiring comparable prices for United States and Canadian sales (see answer to Question 19).

(2) The Canadian Uranium Export Review Board reviews all uranium exports from Canada. The principal restriction imposed on exports has been the uranium upgrading requirement, which Canada has agreed to eliminate with respect to the United States (see answer to Question 10).

(3) Canada has not directly restricted U.S. uranium sales to Canada. The requirement that Canadian exporters of uranium demonstrate that such exports were surplus to Canadian needs has been interpreted as a requirement that Canadian utilities have long-term contracts to supply their needs. There is no reason in principle why such contracts could not be for U.S. origin uranium, and we have been assured by Canadian negotiators that there are

no prohibitions against the bids of U.S. suppliers to meet these needs.

(4) U.S. ownership of Canadian uranium goods is not restricted under Canadian laws or under official regulations issued pursuant to those laws. See answer to Question 11 for specific aspects of the FTA related to uranium industry investment.

Question 29. Under the FTA, 50,000 barrels per day of Alaskan oil is expected to be shipped to Canada. In the trade bill under consideration in Congress a similar provision allows such exports as a displacement transaction bringing oil to the Midwest. Is this what is intended? Will exports to Canada be limited to 50,000 barrels per day? Is there any anticipation or any discussion with the Canadians that the 50,000 figure be raised some time in the future?

Answer. The 50,000 barrel per day exemption from Alaskan oil export restrictions for export to Canada is intended to accommodate anticipated needs in British Columbia. However, it is not in any way linked, as in the case of the trade bill (H.R. 3), to a displacement transaction bringing oil to the U.S. Midwest, and that is an important distinction. It is quite possible that these volumes will back out equal volumes of crude oil currently going to British Columbia from Alberta, thus freeing the Alberta crude for export to the U.S. Midwest, but this is not an explicit requirement of the FTA provision.

This volume is expected to be the upper limit on such requirements, given the current technical limitations of British Columbia refineries. No further increase is anticipated at this time, nor has there been discussion with the Canadians of raising the 50,000 figure in the future; should such an increase be requested, it would require an additional change in the law and would have to be judged at that time on its merits.

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown in part 1 of the report, filed by the Committee on Ways and Means.

ADDITIONAL VIEWS OF THE HONORABLE JOHN BRYANT

This United States-Canada Free Trade Agreement Implementing Legislation now before the House, which the Administration is enthusiastically urging Congress to approve, endorses and ratifies the continuation, in a modified form, of the Investment Canada Act, the Canadian government's registration and review process for foreign investment there.

If this agreement is adopted, Canada will, with our government's official blessing, not only continue to require the extensive reporting of most U.S. investment in Canada, but will also continue its prescreening process and other restrictions in the full range of Canadian industries, whose American counterparts are completely open to Canadian investors.

During the debates on H.R. 3, The Omnibus Trade Bill, I offered an amendment merely to require disclosure of major foreign-owned interests in the United States. For most investors, it asks only, "Who are you, where are you from, and what have you got?"—information that would fit on a postcard. Even for controlling interests in large U.S. businesses, it asks only for basic financial data, less than what much smaller publicly traded American corporations already disclose to the Securities and Exchange Commission. It establishes absolutely no restrictions or preclearance requirements of any kind.

Treasury Secretary James Baker and other Reagan officials banded together with foreign lobbyists to defeat my proposal, which asks no more than that major foreign investors sign in after they have walked through our open door. The United States would still have the most open foreign investment policy in the world—in stark contrast to virtually every other nation, most of which not only require extensive registration, but also impose restrictions and preclearance requirements.

Secretary Baker and the Reagan Administration argued that mere registration here would inhibit foreign investment, even though more extensive registration, preclearance requirements and restrictions have not inhibited permissible investments in other nations.

The Reagan Administration hypocritically endorses the Investment Canada Act's disclosure requirements and restrictions on U.S. investment in that country, while opposing minimal registration of foreign investment here.

The Investment Canada Act requires more disclosure than my amendment requires. In addition, it has investment restrictions and a preclearance process. Yet Reagan Administration negotiators have endorsed the Investment Canada Act, part of the United States-Canada Free Trade Agreement, which Secretary Baker is lobbying Congress to approve.

The Administration hails this trade agreement as a milestone for free trade and open investment and as a victory for United States negotiators. In light of Canada's restricting and blocking provisions endorsed in the United States-Canada Free Trade Agreement, I am compelled to ask, "How can Secretary Baker and the Reagan Administration consistently endorse this agreement, but insist that a simple reporting requirement in the United States grossly violates all notions of free trade and open investment."

Although I seriously question the wisdom of the one-sided provision that permits Canada to continue registering, prescreening, and restricting U.S. investment there while our Administration continues to oppose comparable authority for the United States, overall, the good aspects of the United States-Canada Free Trade Agreement outweigh the bad. It will create the largest free trade area in the world, removing all tariff barriers within ten years. It will create substantial international business opportunities for both the United States and Canada. While the enactment of strong and responsible trade legislation will strengthen the United States' hand at the negotiating table and help remove foreign trade barriers to American products, the adoption of the United States-Canada Free Trade Agreement will help set an example of the benefits to be gained from free and fair trade.

But I urge this and future Administrations not to trade away to other nations rights we do not seek to preserve for ourselves.

JOHN BRYANT.

ADDITIONAL VIEWS OF THE HONORABLE MICKEY LELAND

Today this Committee will consider H.R. 5090, implementing legislation for the United States-Canada Free Trade Agreement.

Congressional approval of this historic treaty will greatly advance our guest for freer markets of goods and services in both countries. By eliminating trade barriers, our two nations will experience improved opportunities for businesses and lower prices for consumers.

Despite these benefits, I harbor reservations concerning Chapter 9 of the agreement concerning the energy provisions. In short, this agreement will result in larger quantities of Canadian natural gas and electricity entering the United States. My concern is that increased reliance on these imports will crowd out our domestic supplies of natural gas and electricity. Additionally, the beleaguered United States uranium industry could be hurt by increased imports of Canadian uranium.

The domestic energy industry is still struggling to overcome the economic hardships of depressed energy prices. Energy producing states continue to grapple with high unemployment and depressed economies.

Accordingly, great care must be taken to strike the appropriate balance between increasing Canadian energy imports and reviving our domestic energy industry. While this balance may not be easily achieved, we must continue all attempts to restore the viability of our domestic energy industry. Moreover, the national security requirements of a healthy energy industry cannot be over emphasized.

Last month, the United States enacted legislation renewing its participation in the International Energy Agency. As part of that legislation, I proposed a comprehensive study on Pan American Energy Security. This study, which is now underway by the Departments of Energy, State and Commerce, will evaluate various energy policy options for increasing United States cooperation with other countries in this hemisphere. The study will examine various policies pertaining to crude oil, natural gas, nuclear energy, conservation, and renewable energy. By pooling the energy resource of the Americas, the appropriate balance between free trade and energy security can be achieved.

Further efforts for trade liberalization should continue to be pursued. Perhaps, in due time, the United States and Mexico could reap the benefits of a trade agreement similar to the one we will consider today.

MICKEY LELAND.

ADDITIONAL COMMENTS

The United States-Canada Free Trade Agreement harbors the beginning of a new era in our nation's relations with Canada. However, the agreement is so sweeping that it fails to properly address the concerns of many areas of the U.S. economy which would suffer unduly from swiftly enacting the agreement. This is particularly relevant in regards to the domestic uranium industry.

There is great concern that with the immediate repeal of Section 161v. of the Atomic Energy Act with respect to Canada, the domestic uranium industry will not be able to regain a competitive position in the marketplace. Congress passed the Atomic Energy Act with the express intent of maintaining a viable domestic uranium industry for our nation's energy and national securities. By law the Department of Energy is mandated to maintain the industry healthy and viable. With the partial repeal of Section 161v. of the Act, the Department of Energy will no longer have the tools to carry out its mandate.

Due to changing energy policies, there has been a decrease in the number of nuclear power facilities being constructed with a consequent reduction in demand for uranium and a substantial increase in uranium stockpiles. Moreover, the domestic industry is saddled with the costly responsibility of reclaiming residual mill tailings cast off in the mining process. The cumulative effect of these factors, combined with increasingly vigorous foreign competition, have placed the domestic uranium industry at an insurmountable disadvantage as it attempts to regain viability and market share.

Lacking any adjustment assistance for the uranium industry, implementation of the Free Trade Agreement does not allow the domestic uranium industry either sufficient time nor the means to surmount its many problems. If the Congress does not address these crucial issues in the near future, it is unreasonable to expect that our nation will ever again have a viable and competitive domestic uranium industry.

BILL RICHARDSON.
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